

Federal Reserve Board Oral History Project

Interview with

Paul A. Volcker

Former Chairman, Board of Governors of the Federal Reserve System

Date: February 25, 2008; January 28, 2008; July 22, 2008; July 28, 2008;
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December 29, 2009, and March 24, 2010, David H. Small and Jeffery Ernsthausen

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.

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February 25, 2008 (First Day of Interview)

MR. SKIDMORE. Today is February 25, 2008. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. I am Dave Skidmore of the Board's Public Affairs Office. I'm joined by David Small of the FOMC (Federal Open Market Committee) Secretariat in the Division of Monetary Affairs. We're interviewing Paul A. Volcker, Chairman of the Board of Governors of the Federal Reserve System from August 6, 1979, to August 11, 1987. This interview is taking place at the Board.

Our goal this afternoon is to walk you through your early years in Teaneck, New Jersey, and in school: the people, places, and experiences that influenced you as you were growing up. So with that preamble, I thought I would get you started by asking you about your earliest memory. Was it in Cape May where you were born, or in Teaneck where you grew up?

Family Background

MR. VOLCKER. My memory of Cape May is extremely limited. I have some vague memory of playing in the sand at Cape May Point when the family rented a house. It was an old frame house at Cape May Point. That's about all I remember about Cape May. I've gone back there from time to time.

MR. SMALL. This would have been around 1930?

MR. VOLCKER. Yes, about 1930.

MR. SKIDMORE. Could you reflect about your parents and your three sisters and what their lasting influence was on you?

MR. VOLCKER. My parents obviously had a lasting influence. My sisters were all older than I was. Ruth, my oldest sister, was probably 12 years older than I was. By the time I was compos mentis she was almost off in college. She was a guardian angel. She would flit

back into my life once in a while. She usually brought me a candy bar or something. My second sister, Louise, was a bit younger than Ruth. She was the more emotional one in the family. She had artistic and literary pretensions; she was really good in both. But she had her ups and downs, which I remember preoccupying a lot of attention and which I probably resented. Virginia, my youngest sister, is two and a half years older than I am, and we grew up more or less together.

I always have the feeling now—I say this half-jokingly, but it's only half-jokingly—stemming from being the first male on the paternal side of my family in my generation. There were a lot of Volckers in Germany in my grandfather's family; there were 9 or 10 boys in that family. By the time it got down to me, I was the first male out of that whole line of 10 males. I had all these older sisters. Finally, a male was produced. I kept getting told that story. I always had the feeling they were pretty careful that this one boy with three sisters was not going to be spoiled. I make a joke about it, but I think there was something to it.

I can tell you the story of why I probably don't like inflation. I love to tell the story. In 1945, I was going off to college at Princeton, and my mother said, "We'll give you an allowance of \$25 a month." I said, "That's not enough. I'm a boy. I need more than that." My mother said, "That's what your sisters got, and that's what you're going to get." I said, "My sisters don't need as much money. Ruth went to college in the middle of the Great Depression, and so did Louise. And we've had inflation, Mother. I need more." She said, "I don't care." So I wrote a letter to all my sisters and asked whether they felt it appropriate that I get more. And they did, given inflation. They all wrote back dutifully to my mother. They agreed that I should be entitled to more money. My mother said, "I don't care about all that. You're going to get \$25, just like what your sisters got."

MR. SMALL. So your mother fought inflation.

MR. VOLCKER. Yes, my mother had money illusion.

MR. SMALL. Any sense in your household of appealing to your dad over that?

MR. VOLCKER. No, he was aloof from that. I don't remember whether I appealed to him or not. I don't remember appealing to him. I think it was just known he would say, "That's your mother's decision." [Laughter]

MR. SKIDMORE. What effect did it have in making you the person you were to have three older sisters?

MR. VOLCKER. I don't know what impression that really made upon me. I kept getting reminded in school that my sisters were nice and calm and that I was so rambunctious.

MR. SKIDMORE. Did it make you rebellious?

MR. VOLCKER. No, what made an impression was that my father was a city manager. He was very well known. That ingrained into me that you keep yourself out of the news, and don't do anything that anybody can criticize. I don't remember getting any lectures about it.

MR. SKIDMORE. Later in life, you didn't listen. You got into the news.

MR. VOLCKER. "Don't get in the news for doing something wrong" would have been the lesson. I was inhibited in that respect, I'm sure. Once in a while, when the boys went out and had a little fun on the town, I'd say I was going home. I was very conscious that my father was very well respected. Anybody that knew Teaneck knew my father was the head of Teaneck, so to speak. That affected me in various ways. It inhibited me in that sense.

The whole idea of public service was rooted in my experience with my father. He used to tell me, "Don't go into government, go into business." But it was monkey see, monkey do. I was fortunate, because his controversial period was when I was so young that I wasn't very

conscious of it. By the time I was growing up, he was the image of Teaneck, and Teaneck had a very good reputation.

This was in the middle of the Great Depression. Teaneck was only three or four miles from the George Washington Bridge. The George Washington Bridge opened around 1930. Teaneck got a flock of people from New York moving out to suburbia. It was a favorite place to go. In one sense, Teaneck was an old town. It wasn't all that well developed. It grew rapidly in the 1930s.

Unlike many of my compatriots in age, I didn't have the sense of growing up in the middle of a great depression. You vaguely knew it was there. I can remember tramps coming around—they don't exist anymore, they're called "homeless"—knocking on the door and asking for supper or something. My mother would dutifully give them something. That would happen once in a while. But I don't know whether my family ever felt insecure. As a child, I never felt insecure. My father had a job and a reasonably good income. We weren't rich, but we weren't poor.

MR. SMALL. I thought I read that the opening of the George Washington Bridge spurred some speculation in town. The city overexpanded or something, and that led to some of the financial problems that your dad had to address.

MR. VOLCKER. Teaneck was virtually bankrupt when a taxpayers' league was developed to reform the government. They kicked out the old government and adopted a "council manager" form of government. My father had been city manager in Cape May, New Jersey.¹ He was the first city manager in New Jersey. City managers were not all that common.

¹ In accepting the resignation of Paul A. Volcker, City Manager, the City Council of Cape May expressed its "sincere appreciation for the manner in which this office has been conducted during the last five and one-half years. Also, we feel mention should be made of the great constructive work carried on by him during this term, not only in

Teaneck hired him out of this reform movement. He got them out of the near bankruptcy and refinanced the debt. He got credit for being the principal force in rewriting the state law about that form of city government.²

I was old enough to be vaguely conscious that something was wrong at one point when he came home early from a council meeting. A few of his buddies accompanied him. They went off in a room on the side and engaged in deep discussion. At that time, he lost a majority on the council. There was a point of principle. The council wanted my father to appoint one of the good old boys as police chief, and he said, "I'm not going to appoint him. It's my job to appoint the police chief, and I'm appointing this other guy, a professional from out of town." So the council majority at the time had a big fight and suspended my father. I don't think his suspension lasted very long, but he went to court, and he won, and that established a principle in New Jersey that, indeed, the law said if you had a council manager form of government, the town manager was responsible for appointing the fire chief, the police chief, the public works chief, so forth.

MR. SKIDMORE. Did he ever talk explicitly about his attitudes towards public service? Or what do you think his attitude was?

MR. VOLCKER. I don't remember there being very deep conversations, but he would always say to go become a businessman. That was always his theme. He didn't develop it very far. He was a civil engineer and had gone to Rensselaer Polytechnic Institute. His great desire

the rehabilitation of the plant of Cape May but on account of the constructive and intelligent method in which our finances have been put in the workable shape in which they are found today." Resolution No. 160. Passed unanimously on November 25, 1930, City Council of Cape May, New Jersey.

² For a tribute to Paul A. Volcker, Sr., for his work as municipal manager in Teaneck, New Jersey, see Teaneck Taxpayer League (1950), "A Profile of Paul A. Volcker."

was that I go to Rensselaer and become an engineer. I applied there and got accepted. This was during the war, so it wasn't hard to get in college.

I don't even know why I applied to Princeton. That was beyond my aspirations at the time. My mother and my father kept telling me that Teaneck High School was not much of a school, and they should have sent me to prep school for a better education, and blah, blah, blah. Princeton, as far as I was concerned at that time, had a bunch of rich snobs [laughter]. There was some truth to that, all that Gothic elegance and so on.

MR. SKIDMORE. Who told you to apply?

MR. VOLCKER. I don't know. It may have been a teacher. I remember getting the application, which was on heavy parchment-like paper. I filled it out and sent it to Princeton. Two weeks or a short time later I got an acceptance. Princeton hadn't been accepting many people from public high schools—they may have had one or two from Teaneck before. Anyway, I went, but it was almost an afterthought. Otherwise, I would have gone off to Rensselaer and become an engineer, and God knows what would have happened to me.

MR. SMALL. Once you got accepted and you had the decision in front of you to go to Rensselaer or Princeton, what was your dad's reaction?

MR. VOLCKER. He wasn't too happy. [Laughter] He didn't say no, but he kept saying, "You're going to find a bunch of bright guys at Princeton who had a lot better high school education than you ever got, and you're going to be in trouble."

MR. SKIDMORE. And what was your reaction?

MR. VOLCKER. He worried me a bit, so I worked pretty hard the first semester. They used to mark you 1, 2, 3, 4, 5, 6, 7. I got all 1's. I thought, "This is no harder than it was in my

high school,” which was probably a bad lesson. From then on, I didn’t work very hard.

[Laughter]

MR. SKIDMORE. Did he know that about you? Was he trying to scare you? Why do you think he said that to you?

MR. VOLCKER. I don’t think he thought I was dumb by any means. To say he had a guilty conscious is too strong. My parents wanted to send me off to private school someplace. I said, “Nothing doing. I don’t want to go to private school.” I think he felt that they hadn’t pushed me hard enough.

I didn’t work very hard in high school. There were so many things to do. I played basketball. One basketball season, which went from November to late February or March, I took great pride in that I never took a schoolbook home. [Laughter] You had study halls where you did homework for the history class, the Spanish class, the English class.

MR. SKIDMORE. When, if ever, did your work ethic change?

MR. VOLCKER. It never changed. It hasn’t changed to this day. I cannot get anything done, typically, until I’m up against it. If something’s coming along and I know I have to do something, I put it off and off and off—typically, writing a speech or anything. Don’t do it today if you can wait until tomorrow. Obviously, when I had a lot of responsibility, I worked hard, but I’m very good at procrastinating, as people around here could tell you, I suspect.

MR. SMALL. Did your father talk to you about his role in city government, about managing people or running an organization?

MR. VOLCKER. I don’t remember any conversation like that. But one of the things that made an impact—and I don’t remember him talking about it—was that he was really straitlaced

about improprieties, whether it was outright fraud of some sort or cheating or some indication of a conflict of interest or something.

MR. SMALL. Did he talk to you about engineering?

MR. VOLCKER. He loved to sit down and explain to me how the stresses on a bridge worked, the different kind of trusses you could make, and the way a suspension bridge worked. Engineering was his first love. And he liked to go fishing.

MR. SKIDMORE. What was his view of public service?

MR. VOLCKER. He must have found it satisfying. I don't know what opportunity he ever had for moving into some position of business responsibility. I never heard about it. When he graduated from college, he worked for the State of New York as an engineer. He met my mother when he was rebuilding the Erie Canal in a town in which she lived. He became city engineer in Lebanon, Pennsylvania. But for some reason, he then became head of the local Chamber of Commerce, an executive job. From there he became city manager in Cape May. Becoming head of the local Chamber of Commerce didn't indicate any antipathy to business, for sure.

MR. SKIDMORE. What do you think made him an effective manager [and] leader?

MR. VOLCKER. I think, in those days, civil engineering training was not uncommon among people both in government and business management positions. In those days, if you looked at the presidents of big companies, not atypically, they started out as engineers. That never happens now. They all start out in finance. I don't think that's for the better. They went from being engineers to being marketing-type persons. Now they're all financial-type people. I do think there's something about training as an engineer that creates a mental framework of logical straightforward thinking. It's not true of politicians, but I think it's true of a lot of good

managers. By some instinct, my father must have been a good politician too, because he became very popular in town. I don't think he was particularly at ease in speaking and at parties and that kind of stuff. That was not his cup of tea.

MR. SKIDMORE. But he knew how to get people to work in the same direction?

MR. VOLCKER. He professionalized the fire department, the police department, and so forth. He respected the people he brought in, and I think they respected him. He worked very closely with them.

MR. SKIDMORE. What about your mother?

MR. VOLCKER. My mother went to Vassar, which was a great women's college in those days. I'm not quite sure why she went to Vassar. She came from a little town in upstate New York, which had a graduating class in her high school of 14 people, as I remember. She was valedictorian of her Vassar class. I don't know whether that meant the others were all socialites or something, not paying any attention, but she was obviously intelligent and concerned about the world. She always felt very strongly about Vassar until it went coeducational. That almost killed her. She shut off all relationships. [Laughter]

MR. SKIDMORE. Did she have a sense of public service or of what were good things to pursue in life?

MR. VOLCKER. I don't know if it was public service per se. She was not left wing politically, but it was not atypical of her that she didn't want me to look for a job in the 1930s, because our family didn't need a job and other people needed jobs.

MR. SKIDMORE. Did you have any jobs as a boy?

MR. VOLCKER. I delivered newspapers for a while. I had a couple of jobs raking leaves for the school board. There was a minor job for which the town was hiring some boys. Apparently, my father discovered I'd been hired and he blew his top.

MR. SMALL. You talked about being the manager's son and being visible and having to keep out of trouble. Do you remember any particular instance where you dreaded going home because Dad or Mom would be waiting for you?

MR. VOLCKER. When I was a little kid, one of the favorite things you did was go out and throw stones to see who could knock out the streetlights. Once in a while, the police came around and got you. I didn't want to be out there at the time that the police came. Also, there was a diner in town where the fast high school crowd hung out. By today's standards, it was very benign, but it was still a fast crowd of girls and boys. I don't know if they ever did anything, but I knew my mother and father would not look kindly on my hanging out with them.

MR. SKIDMORE. What would have happened if you had been hauled in by the police for knocking out a streetlight?

MR. VOLCKER. I assumed it would embarrass my father.

MR. SKIDMORE. What would have happened to you?

MR. VOLCKER. Nothing would have happened to me. I would have gotten a talking to. But I suppose the affair would appear on some police docket that the local newspaper guy looked at. You weren't going to be put in jail. You just got reprimanded.

MR. SKIDMORE. You had three older sisters—presumably, all trying to tell you what to do. What was your reaction to that?

MR. VOLCKER. The oldest one was my favorite sister because she was away. She wasn't telling me what to do. She would just appear once in a while as this angel from outside

and bring me a little present. I never had any conflict with her until years later: She sold me her old car, and it didn't work very well.

My second sister was high maintenance. She went through cycles of being unhappy and happy, having boyfriends or not having boyfriends, and teachers not treating her right. I can remember many times sitting in the breakfast area, minding my own business, and there was Louise, dominating my mother with all her trials and tribulations. We actually became very close as adults, and she took great pride in my career before she died in her 40s. And I came to realize how talented she was.

My sister who's closest to me was placid in personality then, and she still is. I used to squabble with her because we were the two young kids. In the back of the car, we fought with each other.

MR. SMALL. You told a story about your father and friends going into the other room at your house when he almost lost his job, about his role as the city manager, and how he stuck to principles. Do you remember being impressed by that?

MR. VOLCKER. No, all I knew was that something odd was going on.

MR. SMALL. But later on you came to respect that in him?

MR. VOLCKER. Yes—when I understood what the problem was later, of course, yes. He sat there and wasn't going to have his prerogatives overridden—sound familiar?

MR. SMALL. But later on in life, whether it was Bretton Woods or fiscal or monetary discipline, did you hearken back to those days?

MR. VOLCKER. No, I don't think consciously. But you just knew. I must have discussed it some—it was in the paper, of course—that that's the way you acted when it was

your responsibility and in the public interest. You defended it. And you took the responsibility you're supposed to have.

When somebody came in to see my father, right behind his desk they could see a saying: "Do not suffer your good nature to say 'yes' when the public good requires that you say 'no,' " signed "George Washington." I always remember that. It was a good thing to have behind the desk when all these supplicants were coming in. When I was much older, I asked reference librarians who I knew to find that statement by George Washington, but none of them could find that George Washington ever said that. I began thinking my father made it up and put it up there. Just a month or two ago somebody found it and sent it to me.

MR. SMALL. Did your dad talk about national politics?

MR. VOLCKER. I was compos mentis enough to know in the 1930s there was a lot of conflict about national policies. Teaneck was not one of the richer suburbs, but it was affluent in relative terms. It voted 6– or 7–1 for Republicans in those days.

And I can remember overhearing conversations that my father had. At a meeting, a dinner or something, people were bellyaching about Roosevelt: "That communist, he's driving us crazy. The country is going downhill," et cetera. That was not uncommon. My memory is, my father was always silent. He never engaged in that. He never engaged in an argument on the other side, either. I saw that my mother and father were very cagey about expressing political opinions. I think my father voted Republican, and he probably voted against Roosevelt. I think my mother voted for Roosevelt but never admitted it. [Laughter] She didn't make a big deal out of it in Teaneck, but I'm morally certain she was a closet Roosevelt supporter.

MR. SKIDMORE. What was it like growing up during the Depression?

MR. VOLCKER. It didn't affect me that much. My father volunteered to take a cut in salary during the Depression. I didn't know about it at the time. I knew about it later. Then he kept refusing to take salary increases later. This did impress me.

I don't know when I became conscious of it, but every year he would write out a report on the state of Teaneck, so to speak. It had complete budget figures. It wasn't a very big city, but the report would have the number of policemen, what their salaries were, what the police chief was getting paid, and it had my father's own salary. The report had the principal challenges for the police department the previous year, how many patrol cars and fire engines the city was going to buy next year, how many fires were put out, how many streets got paved, and all this stuff. Not many towns put out that kind of report. I think the report was part of the image of being a well-managed town.

MR. SMALL. And then you come along, with the reputation as one of the most secretive Federal Reserve Chairmen.

MR. VOLCKER. [Laughter] Well, that's not right on the administrative stuff. I don't think it's right on the policy either. I know that is the reputation. But, you know, bureaucracies like to hide things. Halfway or two-thirds through my tenure, maybe, I made us put out an administrative report every year.³ I don't know if we did it more than a couple of times, and I don't know whether you still do it. But I remember having to fight with the bureaucracy when they wanted to obscure a few expenditures that were a little embarrassing and so forth. Do they still have such a report?

MR. SKIDMORE. There's the annual report budget review. It's a supplement to the annual report.

³ See Volcker (1986) [for more on this topic].

MR. VOLCKER. I'm not talking about the annual policy report.

MR. SKIDMORE. But this budget review report goes through essentially the budget and what you're talking about, who's employed where. It has a narrative like you were describing with Teaneck.

MR. VOLCKER. Go back and look at that. I'm sure that started during my tenure. And I started it because of my father. I thought it was a good idea to give more attention to congressional oversight on this kind of stuff. But it's not very exciting for the Congress. My philosophy was, I would welcome this, because I wanted to keep expenditures under control in the Federal Reserve. The whole pressure of bureaucracy is always to increase, and I didn't want to be the fall guy all the time in saying "no." I was willing to say "no," but just as well I could say, "It won't look good for the Congress, and they won't like it."

MR. SMALL. How long was your father alive and following your career?

MR. VOLCKER. He was born in 1889 and he died when he was 70, in early 1960. I was at Chase Manhattan Bank when he died. I assume he took pride in my early Treasury experience, but maybe there was a bit of rivalry.

MR. SKIDMORE. What was the origin of the Volcker family frugality? It sounds like your father kept the reins on at Teaneck. Your mother wouldn't give you a bigger allowance in college.

MR. VOLCKER. Well, I guess you're right. I don't know where it came from. We were always living on a civil service salary, but in those days it was relatively better than I think it is now. His basic salary before he reduced it was \$8,000 a year, which was not a bad salary in the 1930s. But still, you never had the feeling you were wealthy in my family. There was clearly a strong sense of Protestant reserve.

MR. SKIDMORE. Why did he reduce it? Most people don't volunteer for salary reductions. What was it about him that made him turn down raises?

MR. VOLCKER. I think he thought we were in the middle of a depression, and everybody was not doing very well. He had a reasonably good salary, and he thought it was a good idea to show a little leadership, I guess. Nobody thought we were rich. But there were a lot of people who were not as well off as we were.

MR. SKIDMORE. Was your family's frugality a good quality or a bad quality?

MR. VOLCKER. I don't remember being particularly conscious of it. With four children, my father had somebody in college for 16 straight years. That was paid for without any scholarships or anything, although tuitions weren't what they are now. We didn't sit around agonizing about it. But when I look back, I realize that my father made \$8,000 a year, or less than that when he reduced it. Having somebody in college was probably \$1,500 a year or more, and it went on for 16 years.

MR. SKIDMORE. That was an impressive accomplishment, to get all four of you through college.

MR. VOLCKER. In my family, you went to college. There was never any question of that. If you didn't go to college, there would have been a revolution.

MR. SKIDMORE. Did you feel that your family's attitude towards your sisters was different than other families, that your family had higher aspirations?

MR. VOLCKER. It was unusual. My mother went to college, and not many women were going to college in 1909 or even in the 1950s. And there was no question about my sisters going to the best. This is just Americana. My father went to Rensselaer in Troy, New York, in 1907. I got an honorary degree up there a couple years ago, and they gave me the yearbook for

the class of 1911. According to my father, anyway, but I think it's true, Rensselaer was a pretty well-known engineering school in the early 20th century—began in the 19th century. They considered themselves more or less like MIT. Well, MIT, of course, got much better. But it was, I think, a well-known engineering school.

What struck me, looking at that yearbook, is that 80 percent of the students came within 30 miles of Troy, New York. People were not traveling any distance to go to a university. When you think about it, the car was brand new. People didn't have cars in those days. How did you get anyplace? It struck me how few students there were from New York City. He came from New York City, but there weren't many other students from there. And Troy was easier to get to, because the railroad went straight up from New York to Troy. But if you weren't living on the rail line, how did you get there unless you were right in the surrounding area? I guess that's the way all colleges were in those days. I suppose even at Harvard for 1900, 70 percent of the students probably came from the Boston area.

MR. SMALL. Do you remember any family lore being passed down to you from your mom or dad?

MR. VOLCKER. There were a few stories about my paternal grandfather, who was still alive when I was young. He was born in Germany. He came to the United States when he was around 19 years old.

There'd be stories around the dinner table sometimes. My father was the oldest of three boys. The collective family always met at our house at Christmas or Thanksgiving. We used to have 25 people around the table. I remember, at Christmastime, moving the Ping-Pong table into the dining room. We had family stories of my uncles and so forth. There was much speculation

about why my grandfather left Germany to come to the United States. I always figured he was probably escaping conscription, but I don't really know.

MR. SMALL. What year did he come?

MR. VOLCKER. He would have come in the late 1870s or in 1880. He died in 1936 or 1937. I knew he came from the town of Meppen. It was on the Dutch border. His father, I was told, was the local superintendent of schools in Meppen. It was a professional family, I guess. There were 10 boys in the family and 1 girl. My friend Anke, who comes from Germany, wanted me to go with her to Germany, so we went. She came from Hannover, which is 100 miles or so from Meppen. She got her brother to go reconnoiter.

The superintendent knew my name, and he had some vague idea that my great-grandfather had something to do with school. He ended up in a local historic gymnasium that goes back centuries. It was a Catholic gymnasium at the time. There were not many Catholics in that part of Germany, so it was a little unusual. This was a little Catholic enclave, quite historic. Anke's brother talked to the headmaster. The headmaster wasn't very interested in following this up. But somehow he mentioned my name, and then the headmaster woke up a little bit. Germans tend to respect central bankers!

MR. SKIDMORE. This was when you were Chairman?

MR. VOLCKER. No, this was a couple of years ago. So he opened up a little bit. He looked at the books and found out that my great-grandfather was the headmaster of this place in 1850 or whenever it was, and for some years. Then they found out where the house was. It was still there. The gymnasium was connected to a historic Catholic church there. The church had the records of the family, weddings, children, and so forth. He looked at the records of my grandfather when he was born. He was the third child. The records would give the person's

name and then the name of that person's godfather. For my grandfather's family, it got down to the seventh child and listed the godfather as Kaiser Wilhelm, which surprised everybody. The story is that, in those days, that was the population policy of the German Reich. The seventh boy had the Kaiser as an honorary godfather.

MR. SKIDMORE. Did you spend enough time with your grandparents that they influenced you in any way?

MR. VOLCKER. My grandfather was retired by the time I knew him. He was big and tall. He had a mustache and a goatee. To me, he looked exactly like Robert E. Lee. When I first knew him, he had a place in the country by a lake in Pennsylvania. He liked to go fishing, and he had this place out in the middle of nowhere, dirt road and so forth. Then they moved quite close to us—I think to be close to his son and family. I used to see him, because we used to go to his house every week or so. As a child I got dragged along, and we played pinochle with Grandpa while my father sat in the corner reading the newspaper and my mother entertained my grandmother or vice versa. And whoever won the pinochle game got a Baby Ruth. My sister often played.

MR. SMALL. Did your grandfather spoil you because you carried the family name?

MR. VOLCKER. My grandfather thought that I was—there's a name for it—*Stammhalter*: the name holder. There's no question that my grandfather was very happy that the family had finally produced a boy.

MR. SKIDMORE. What was Teaneck like when you were growing up there?

MR. VOLCKER. It was a pretty rapidly growing commuter town. There was a lot of building. It had a couple of old sections, and there were a lot of new sections. It was considered a good place to go. It had an increasingly large Jewish population. Didn't start out at all Jewish,

but it became a favorite place for not necessarily rich but more affluent German Jewish families that were probably largely refugees from Germany. They had located in the Washington Heights area in New York. There was a big enclave. Henry Kissinger, Henry Kaufman, and Alan Greenspan were all from the same area. When they began moving out of the city, after the bridge was built, Teaneck was nearby. It became known as a model progressive city. There is a large Jewish population now. I think there are three or four huge synagogues in the town.

MR. SKIDMORE. What kind of awareness did you have of what was going on in Europe in the 1930s during the rise of Hitler? I guess you would have been a young teenager during World War II.

MR. VOLCKER. By the time the United States got into World War II, I was 14 years old. So I certainly followed that. I have this memory. I was on a fishing vacation with my family in Maine in September 1939. I remember walking back from the boat after being out on the lake fishing and walking by a house that had the radio on announcing the beginning of the invasion of Poland. I was pretty young then. But by the time the war went on, I was a teenager in high school. I was about to go into the army at the end of the war, but the war was over. You were very conscious of the war.

MR. SMALL. Do you remember ever thinking that we might lose the war?

MR. VOLCKER. I don't think so. I was at a hockey game in Madison Square Garden when Pearl Harbor was attacked. There was an announcement made that all military personnel should return to their bases. Nobody knew what was going on.

I don't remember sitting around worrying about losing the war. I probably sat around worrying about not winning it. But you didn't think about losing the war in the sense you were going to be invaded.

MR. SKIDMORE. In high school were you thinking ahead to when you might be drafted or enlist?

MR. VOLCKER. I had a great conflict in my mind, and it still bothers me. When I graduated in 1945, I was 17. You got drafted at 18. Anyway, I had to register. Some of my classmates enlisted before graduation, including the captain of the basketball team, which annoyed me because we were having quite a successful basketball season. A lot of my classmates wanted to enlist to get in the navy rather than getting drafted and being in the army. That was a popular thing to do.

I got called up in April or May 1945 to get drafted into the army, just when I was graduating. By that time, the war was essentially over in Europe. I thought somehow I ought to be in the army; that's what young men were doing then. It was the patriotic and right thing to do. On the other hand, the war was almost over, and I was ready to go to Princeton. Why would I want to go into the army? That was where my conscience entered in. I knew the height limit was 6 feet, 6 inches. I was a little taller. I decided this all turned on whether I stood up straight when I went to that part of the physical. They rejected me on height. That would not have happened if it had been 1943—"So what with you being over 6 feet, 6." So I never went in the army.

MR. SKIDMORE. It sounds like you're feeling you were responsible for that decision by the draft board.

MR. VOLCKER. I don't know. Even if I had been successful in shrinking down, I don't know whether they would have taken me, because the draft was practically over anyway. I have always felt, "Why wasn't I in the army? I should have been in the army. I missed part of the war."

MR. SKIDMORE. When you were a few years younger, did you anticipate being drafted in the future?

MR. VOLCKER. I don't remember agonizing over it until I came right up against it. A few of my classmates in the senior year of high school opted out of high school to go into the navy. But it wasn't many of them, and, by and large, it wasn't the ones who were going to graduate and go to college anyway.

My father was in some kind of service in World War I. There must have been some kind of National Guard or something. He actually tried to get into the army in World War II. There may have been some effort to recruit people like him to be in the administrative side of the army. I think he wanted to do it. I don't know whether it was a physical problem or whether they didn't want to take government officials or what. I remember him talking about it frequently at the dining room table. I don't know why it didn't happen.

MR. SKIDMORE. Growing up, who was your closest friend?

MR. VOLCKER. That varied. By and large, the closest friends I had in high school I didn't see after high school. I have one close friend who went to Princeton with me out of high school. I knew him reasonably well, but he wasn't one of my close friends in high school. I still know him.

MR. SKIDMORE. Is he the one who became a doctor outside Philadelphia?

MR. VOLCKER. Yes, Donald Maloney. I don't see much of him, but we're going to take a trip together next summer. He's become president of the class. God knows, this guy from Teaneck becoming president of his class at Princeton. He was my roommate when I first went to Princeton, but then, later, I had other roommates from Teaneck who were a class ahead of me

and had been in the army or the navy or whatever before Princeton. I was much closer to them. I see them rather infrequently. But in the first years out of college, I'd see a lot of them.

MR. SKIDMORE. As a boy, what did you like to do?

MR. VOLCKER. You went out in the street and saw who else was around and got a little stickball team together. You played touch football. In the summer, you went down to the park to see whether you could scratch up enough people to play a make-shift baseball game. None of this was organized. It was whoever was out in the street. And there were a lot of kids in the street. I did read a lot—there were a lot of books around the house.

MR. SMALL. I've read that Teaneck had some connection to Ozzie and Harriet. That they were from Teaneck, or the show was filmed there?

MR. VOLCKER. I don't know. Eventually Teaneck became fairly popular with baseball players for some reason, particularly the Yankees. You could cross the bridge and get to Yankee Stadium in 15 minutes. I don't know about Ozzie and Harriet. It is an Ozzie-and-Harriet kind of town.

MR. SKIDMORE. In elementary through high school, were there any subjects that called to you? Did you like school?

MR. VOLCKER. I didn't mind school. I didn't get pressed very hard. I had a math teacher who seemed to us students an old geezer. He had a Ph.D. in mathematics. He couldn't get a college job during the Depression, so he ended up teaching high school. I used to make a little fun of him. I was terrible, because he was a good teacher. It was fairly advanced mathematics for a typical public high school at that time. We didn't have calculus, but we got on the edge of calculus. That challenged me. I probably had to do some homework or do some thinking my senior year.

MR. SKIDMORE. And you were attracted to that?

MR. VOLCKER. Yes. I was pretty good at mathematics. He was the most interesting teacher I had even though I used to make fun in the class. He complained to my father.

MR. SKIDMORE. What made him complain?

MR. VOLCKER. Because I was a wise guy in the class.

MR. SKIDMORE. What was it you said?

MR. VOLCKER. I don't remember at this point, but I remember making myself a nuisance. By this time, I was feeling my oats. I remember the algebra teacher was a woman. I don't know why, but I was obnoxious. She threw the chalk at me and said, "You teach the class." So I said, "Okay," and got up.

MR. SKIDMORE. Did you teach the class?

MR. VOLCKER. Yes, I did for a while. She sat in my seat and made barbs about me, imitating my attitude. I remember that incident. I guess I was bored.

MR. SKIDMORE. It seems most adolescents often are angry about something. What made you angry as a teenager, or what frustrated you?

MR. VOLCKER. Despite what I just said, I was a very shy person. I didn't have girlfriends.

MR. SMALL. Were there any great acts of rebellion against authority that you remember?

MR. VOLCKER. No. I was just play-acting in class. There was no bitterness. I thought I was making jokes and stuff.

MR. SKIDMORE. What made you laugh when you were a child?

MR. VOLCKER. I don't know. Lots of things. My father had a wry, ironic sense of humor. He was much more humorous in a way than my mother ever was. Louise, my second sister, was the one I told you was more emotional. She was clever and lively. When she was feeling good, she was very lively. My mother ran the family. There was a clear division of labor in the family.

MR. SMALL. Any memories of your heart up in your throat about asking a girl out or being asked out?

MR. VOLCKER. I was so shy I never did it. I was unattractive, in my view—big, tall, and gangly.

MR. SMALL. Your sisters didn't encourage you?

MR. VOLCKER. No. You would have thought so, living with three sisters. I never much lived with the oldest one. You would have thought that I would be much at ease with girls, but I was not.

MR. SKIDMORE. If they were all trying to tell you what to do, it may have caused you to want to avoid entanglements.

MR. VOLCKER. That's right.

MR. SKIDMORE. Did the family ever talk about World War I or Woodrow Wilson, the founder of the Federal Reserve?

MR. VOLCKER. Not the Federal Reserve. I don't know what time this would have been, but my grandfather and maybe my grandmother—that would be less so—were upset, because they, in effect, were conflicted. In World War I, my grandfather had brothers and nephews in the German army. And he is in the United States, and his son is in the American National Guard. I remember being told that this was difficult for him.

MR. SKIDMORE. So were his loyalties conflicted?

MR. VOLCKER. I'm sure he thought of himself entirely as an American, but it still wasn't pleasant having relatives on the other side.

MR. SKIDMORE. You mentioned that after the George Washington Bridge was opened, there was a lot of migration out of the city by the German Jewish population, and some of them were refugees from Europe. Did you ever think of that or think of the people you talked to, especially in your later days when you were working with the Swiss banks and the Holocaust survivors?

MR. VOLCKER. I knew there was something of a German influx, but it was still probably relatively small when I was still living there. It kept building later. I was a camp counselor a couple years at a camp that's in Pennsylvania. For some reason, they had a policy of having children of German refugee families go to that camp. Probably a dozen or half a dozen came. They used to be in my cabin when I was a camp counselor. I was aware that this existed. When I got involved with the Swiss Bank Holocaust affair, several close friends, for the first time, told me of their experience in Germany and escaping the Nazis.

MR. SKIDMORE. How old were you then?

MR. VOLCKER. I was a camp counselor when I was still in high school and when I was a freshman in college, so I would have been 17 or 18 years old.

MR. SKIDMORE. Where in Pennsylvania?

MR. VOLCKER. It was on the Susquehanna River near Tunkhannock.

MR. SKIDMORE. Did you go to church as a kid?

MR. VOLCKER. My mother was a Lutheran. My father was an Episcopalian. Apparently, they made a deal. The women would be Lutheran and the men would be

Episcopalian. But I was about five years old, and my father never acted upon this agreement. So one day my mother said, “Come with me. We’re going to go get you baptized in the Lutheran church,” which was only down the block. It was much more convenient than the Episcopalian church I used to go to. I became an usher.

MR. SKIDMORE. How big a role did that play later in your life?

MR. VOLCKER. I kind of dropped it, but my wife was descended from a prominent Moravian family and continued as a Presbyterian. My son had, and has, a substantial role in church life, much more as an adult than I ever did. He was mostly Presbyterian. More Presbyterian than anything else, I guess. He grew up in the Presbyterian Church. His great-uncle—my wife’s uncle—was a Presbyterian minister. But my son’s also been Episcopalian.

MR. SMALL. What were your strengths as a student?

MR. VOLCKER. My strength was unquestionably getting good marks. I was very good at parroting back to professors what they wanted to hear. [Laughter] I couldn’t understand why other students were having so much difficulty. I was reasonably good at mathematics, so the scientific stuff was not all that difficult. I never got very advanced in it. For the more literary stuff, I could parrot back what I thought the teachers wanted to know. I was okay on the mathematical side. It all came fairly easily. I didn’t push myself as hard, in retrospect, as I should have.

MR. SMALL. How were you as a parent to your kids on schoolwork and standards?

MR. VOLCKER. In my opinion, I didn’t push them very hard, but they may think otherwise. My daughter was good, particularly as she got into high school. She was the opposite of me. She had no shortage of boyfriends and other extracurricular activities. My son has cerebral palsy. He worked hard and got through school and college quite well, but he had to

work, particularly on any mathematics stuff. He had to work very hard. I'm very proud about how he's handled his disability.

I worked hard—full speed—when I was in the government. Don't let me give you the impression that I didn't work hard when I was in the Treasury or in the government.

MR. SKIDMORE. You seem to work hard in certain settings but not in other settings.

MR. VOLCKER. Absolutely. In high school and even in college you're thought of as showing off almost, not in a very public way: "I can do all this without any work, isn't that wonderful?" I didn't go around bragging about it, but I'm sure that's the way I felt. That was my accomplishment when I was not so good at other things. It's a stupid thing to have an accomplishment about. But when I had some responsibility, I worked. I wanted to get A's. It was how little work could you do and still get an A.

MR. SKIDMORE. If you were writing your memoirs and you were going to write the chapter on your early years, your youth, what would be the two or three things that you'd want to convey to people?

MR. VOLCKER. It's the influence of the family that we have been talking about. Providing the picture of what it was like having a childhood in the 1930s, which is so unlike the structured stuff you get now.

Other friends have written autobiographies. And they have all got something challenging to talk about. Their families were refugees, and Nazis came in, Kristallnacht, and broke all their windows, and they had to walk 200 miles to get out of Germany and get into France, and all those challenges. In comparison, I had this perfectly placid upbringing in the middle of the Depression and war. What have I got to say about it? If I write a memoir, who cares about growing up in Teaneck, New Jersey, in the middle of the Depression when it wasn't really

affecting me? I didn't have to scramble around wondering where my next meal was coming from. My mother was taking in tramps and hiring people just because she wanted to give them a job. That doesn't sound very exciting.

MR. SKIDMORE. I think what people want to know is how those experiences, ordinary or placid, influenced your way of behaving or thinking when, later, you were in positions of responsibility, for which you are well known.

MR. VOLCKER. It will be a short chapter.

January 28, 2008 (Second Day of Interview)

MR. KOHN. Today is Monday, January 28, 2008. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve. I'm Donald Kohn, Vice Chairman of the Board. I'm joined by Lynn Fox and Dave Small of the Board staff. We're interviewing Paul A. Volcker, former Chairman of the Board. This interview is taking place at the Board.

Paul, the point here is to walk you through your career and get your evolving views of the Federal Reserve and the policy process. This approach is to get an overview, and in future interviews we can return to particular topics that you might want to cover in greater detail.

Education and Early Training

MR. KOHN. The first subject is early training: your experiences at Princeton, Harvard, the London School of Economics, and the Federal Reserve Bank of New York.⁴ Can you tell us who the important influences on your intellectual development were through those early years?

MR. VOLCKER. Your assumption is, I've had some intellectual development.

[Laughter]

MR. KOHN. Yes. I thought the tricky assumption is that somebody could influence you.

[Laughter]

MR. VOLCKER. I don't know who I could pick out. I don't know when I first heard of the Federal Reserve. But I remember taking a course in money and banking at Princeton from Friederich A. Lutz. He was very good and logical, and I liked money and banking because it

⁴ Paul Volcker earned a Bachelor of Arts degree, summa cum laude, from Princeton University in 1949 and a Master of Arts degree in political economy and government from the Harvard Graduate School of Public Administration in 1951. He worked at the Federal Reserve Bank of New York as a research assistant during the summer of 1949 just before entering graduate school at Harvard and during the summer of 1950 while in graduate school at Harvard. From 1951 to 1952, he was Rotary Foundation Fellow at the London School of Economics.

seemed more precise than other economics. You had the balance sheet. Only later did I understand that the balances were not always what they appeared to be. [Laughter]

You had to write a senior thesis at Princeton. I was never a very energetic student, to say the least, and I kept putting it off. I was graduating in February instead of in June. Frank D. Graham, my professor and adviser, was well known on international trade issues. I remember going to see him. I said, “I’m getting a little worried. I haven’t got much time for this thesis.” He said, “What are you worried about, it’s September.” I said, “But I graduate in February.” And he said, “Oh!” [Laughter] I don’t know who suggested the topic of the Federal Reserve, but it sounded easy and relatively straightforward.

MR. KOHN. What year was this?

MR. VOLCKER. This would have been the fall of 1948. I holed up in the library. I was looking up the Federal Reserve and the real bills doctrine—all the debate that went on in the 1920s when open market operations were first understood to the extent they were understood.⁵ I would write out a chapter and take it to Frank Graham. In a few days he would read it and give me some comments. He read that stuff in my awful handwriting, which no professor would do now. I wrote the thesis and he gave me a good mark. That made my career.

MR. KOHN. The title of your thesis was “The Problems of Federal Reserve Policy since World War II,” so you wouldn’t have been focused on “real bills,” you might have been focused on the Federal Reserve fixing interest rates.

MR. VOLCKER. This was a time when interest rates were fixed. But I did two or three chapters on the history where “real bills” came up.

⁵ As expressed in the Federal Reserve Act, the real bills doctrine limits, in normal circumstances, the private-sector assets eligible to serve as collateral for discount window loans to commercial paper used to finance the production of goods and services.

At that time, Citibank had a monthly letter. One of three or four well-known economists wrote the letter. I got Citibank's monthly markets letter, and I read about what the Federal Reserve did wrong and right. I went through it all. That is how the last few chapters of my thesis were written. I remember sitting in my carrel in the library copying out National City Bank's stuff and their sources, too.

I remember being impressed by the argument that the Federal Reserve, in practice, was not very independent of the Treasury then. I think it was supposed to be independent. I wrote that if the Federal Reserve can't do a better job of being independent de facto, there's no reason why it should be independent de jure. You'd get better coordination of policy if the Federal Reserve gave up this pretense of independence. I think the saving grace of this conclusion was I said, "If they don't act more independently, give it up." But the Accord between the Treasury and the Fed wasn't until 1951, and I was writing this in 1948.⁶

Anyway, I've gotten turned down for a job twice in my life. When I graduated from Princeton, I knew I was going to graduate school, but I had to get a job for six months. I got on the train to Washington and got a room in a hotel—the hotel is still there, across from the train station, which I am sure was cheaper in those days. I went around and knocked on the doors of the federal agencies; that wouldn't happen today: "Would you like to employ me for six months?" I got to the Federal Reserve and was interviewed by [Richard C.] "Dick" Youngdahl, who at that time I thought was very senior, and by two or three people senior to Dick. They said, "We're sorry. You're a good fellow, but we're not interested in hiring somebody for six months." I got turned down by the Federal Reserve!

⁶ The Federal Reserve committed itself to maintaining a fixed and low interest rate on government bonds to help finance World War II. In 1951, the Federal Reserve and the Treasury announced an agreement, known as the Accord, releasing the Federal Reserve from this obligation to maintain unchanged interest rates.

Then I went to the Federal Reserve Bank in New York. By accident, my father ran into somebody who worked there, and he said, “Why doesn’t he come here.” [Robert V.] “Bob” Roosa takes credit for hiring me.⁷ I don’t remember even meeting him at the time, but he was an assistant vice president.

There was a book by Peter L. Bernstein, who happened to be a friend of Bob Roosa. The book had an appendix about how to read the Federal Reserve statement on factors affecting reserve balances. Nobody looks at that statement anymore. It used to be published. You had to read it in the old days to figure out what the Federal Reserve was doing—what happened to Federal Reserve float and currency in circulation. It was more or less true that I was the world’s leading expert on Federal Reserve float and currency in circulation. You had to make projections, and it was tricky. I didn’t have any computers. I wrote articles on Federal Reserve float and currency in circulation.

MS. FOX. That was your summer position—that was during the summer of 1949?

MR. VOLCKER. I went back the next summer. It was interesting, because I worked in the unit that did the policy stuff—projecting how much government debt should be bought and sold. So I was an expert on the Federal Reserve statement. And Mable Brown, who became Mable Wallich, was there.

MR. KOHN. I think, at Henry’s funeral, you said that you and Henry were rivals for her hand.⁸

MR. VOLCKER. Well, that was congratulating myself, because we should have been. I was so shy. I never thought that Henry Wallich, who was in the foreign research department,

⁷ Robert V. Roosa worked at the Federal Reserve Bank of New York from 1946 to 1960, rising to the post of vice president of the research department. Roosa joined the Treasury during the Kennedy Administration in 1961, serving as undersecretary for monetary affairs until 1964.

⁸ Henry C. Wallich was a Governor of the Federal Reserve from March 1974 to December 1986.

this German guy, would ever impress her. Then I wake up one day, and he's engaged to Mable Brown, my idol. [Laughter] You know Mable Brown?

MR. KOHN. I've met her.

MR. VOLCKER. I'm sorry I wasn't more aggressive. She was attractive.

MR. KOHN. Who else was at the New York Fed in the early 1950s?

MR. VOLCKER. Bob Roosa was the intellectual leader. There was a George Garvey. Arthur [I.] Bloomfield, who wrote a great treatise on the gold standard; Bob Lewis, at my level and who became chief economist for Citibank; and Al [Albert M.] Wojnilower also were there.

MR. KOHN. Al was there?

MR. VOLCKER. Al was there, and Henry Kaufman came there about the same time I was leaving. We didn't overlap very long. [Lawrence S.] "Larry" Ritter came for a while. Do you remember him? He became a famous baseball writer.

MR. KOHN. Yes. He had a banking textbook, too.

MR. VOLCKER. He had a money and banking book.

MR. KOHN. But he wrote about the Dodgers. The textbook was by Ritter and [William L.] Silber.

MR. VOLCKER. Yes. Larry lost interest in money and banking, and he wrote one of the most famous baseball histories: *The Glory of Their Times*.⁹ There was a guy named Joe Conard. He was older and a nice guy. And there was a guy associated with this theory, which made some sense to me, that banks were not unique in the expansion of money, because any financial intermediary could create liabilities that would serve as money.

MR. KOHN. That was John G. Gurley and Edward S. Shaw.

⁹ See Ritter (1966).

MR. VOLCKER. That's been forgotten about, I guess. I think one of them was there briefly. John H. Williams was still there. I didn't have any contact with him, but he was still the great eminence. He was a professor at Harvard. He would go down to the Federal Reserve Bank of New York once a week or twice a week, and he had a big office next to the president's office. But Bob Roosa, without question, was a big driving intellectual force.

MR. KOHN. He was head of the markets operation.

MR. VOLCKER. Let's skip over a little history. I went to Treasury one summer when I was in graduate school before I went to the London School of Economics. I guess it was the second summer of graduate school.

MR. KOHN. You went to Harvard first, and then the London School of Economics?

MR. VOLCKER. Yes, I went to Harvard for two years, and I did the general examination for the doctorate program in political economy. I was supposed to go to London and write my thesis. I was as prompt at that as I was for my undergraduate thesis. During the previous summer, my only exposure to econometrics was that Treasury had some work to review methods of projecting taxes. They had some of the leading econometricians coming in, and I was their office boy collecting statistics. When I left, the Treasury asked, "Why don't we put you on our roll permanently?" I said, "I don't know if I want to come back." But they said, "Oh, we'll do it anyway. We'll put you on leave of absence." As a result of that, I have one more year of credit on my pension. [Laughter]

Anyway, I was in London for more than a year. I came back, and Treasury said, "Will you come back to us?" I said, "I will come back to you if you make me Treasury representative in Beirut," which was glamorous at that time, "or assistant Treasury representative in London." And they told me, "We're not used to taking orders from new employees." [Laughter]

MR. KOHN. So you didn't finish your dissertation?

MR. VOLCKER. No, I barely started it. I had a guilty conscience by the time I left. I started it, but I never finished it.

MS. FOX. What was the topic?

MR. VOLCKER. It would be irrelevant now, but it was to contrast the conduct and transmission of monetary policy in the banking system in the United States (with numerous independent banks) to that in the United Kingdom (with its nationwide banking system with only seven banks that amounted to anything). In those days, my tutor was Richard S. Sayers. He was the leading banking economist in England. He wrote the history of the Bank of England. The thesis would have been a good one if I had ever completed it.

Back at the Federal Reserve Bank in New York, some years later, I was gossiping with a friend, and I said, "I'm going to get to this thesis someday." He said, "How long have you been out?" I said, "It's five years since I've done anything." And he said, "The time limit is up after five years." So I wrote a letter to the secretary of the Graduate School of Public Administration, and I said, "I understand the time for my thesis is up. It's been on my mind. I need an extension. Can I please have an extension?" I got a response back that said, "For your particular degree, there is no time limit." So I'm still eligible.

MS. FOX. You still can do it!

MR. KOHN. This would have been a Ph.D. in what?

MR. VOLCKER. The Graduate School of Public Administration at Harvard at that time was a place where the economics department and the political science department had offices. I had to take a couple of courses in public administration, which I don't regret. But, basically, I was in economics. I took a couple of courses in public administration instead of econometrics.

MS. FOX. You already have a degree from Harvard—the honorary degree.

MR. VOLCKER. Yes, the honorary degree. [Laughter]

MS. FOX. So you could go back and give them the paper.

MR. VOLCKER. Well, I went back there the other day. They had a party for me on my 80th birthday. They said, “We can give you that Ph.D.” And I said, “Not unless I—”

MR. KOHN. Got to earn it. [Laughter]

MR. VOLCKER. Anyway, I went back to the Federal Reserve Bank of New York, and that’s when I was in much closer contact with Roosa.¹⁰ He was an officer, and I was just an economist. He asked me to go to the Trading Desk. It was unprecedented to take an economist and put him on the Trading Desk. I’m sure that was done with great reservation. It was a very bureaucratic institution.

In a way, the Trading Desk was boring, because you sat there with nothing to do day after day except listen to the market. But it was a good experience for me, because it was my introduction to markets. By today’s standards, movements were very small. It was a big day when the government bond market moved 4/32nds. That was a big story. I wrote the reports. I don’t know if they still have the reports. The Trading Desk had to write a report to the Board every week. When the Federal Open Market Committee (FOMC) actually met, they received the report. I spent every Wednesday night writing it, because you had to get it out on Thursday. The Federal Reserve was so bureaucratic that I couldn’t see it after I had written it. My wife couldn’t understand it. I didn’t have a high enough security clearance to read the report that I had written. [Laughter]

¹⁰ After completing his studies in London, Paul Volcker worked at the New York Federal Reserve Bank as an economist in the research department in 1952 and became a special assistant in the securities department in 1955. He left the New York Federal Reserve Bank in 1957 to work as a financial economist at Chase Manhattan Bank.

I actually went to one or two FOMC meetings. Roosa wanted me to take notes for the New York Reserve Bank. So I sat there a couple of times. I was pretty junior.

MS. FOX. Did you think about being in the room as a member of the Committee at that point?

MR. VOLCKER. Oh, yes. I supposed everybody in the Federal Reserve at some point says, "Oh, wouldn't you like to be a Governor of it?" But it was not an active ambition on my part.

There was real warfare between the New York [Federal Reserve] Bank and the Board. I probably didn't realize that at the time. It was partly a fight on doctrine. At the New York Fed, we thought the FOMC should conduct open market operations in all maturities in the Treasury market, while the Board wanted to limit operations to be in short-maturity Treasury bills. It was also a fight on who was running the Federal Reserve System. Allan Sproul was much better known than William McChesney Martin at that point.¹¹ I was at some of the FOMC meetings and had to write up some of this stuff. At the New York Fed, we thought, "Why give up the authority to operate in all parts of the market?"

Debt management was a big deal in those days. We thought in terms of a trilogy of policy instruments: fiscal, monetary, and debt management. We thought that had a significant influence on the economy. And the idea of giving up influence in the bond market didn't make any sense to us. I can remember how emotional this thing got. The New York officials thought, "These out-of-touch people in Washington had too much power." And I am sure Martin was saying the same thing about the New York Fed.

¹¹ Allan Sproul was president of the Federal Reserve Bank of New York from January 1941 to June 1956.

MR. KOHN. If I could take you up a couple of decades—in 1984, right after the Continental Illinois National Bank and Trust Company crisis, you re-raised this issue in front of the Committee. You said, “Why are we buying all those bonds?” You were on the other side. You said, “I don’t know why we don’t own just bills. That would give us a lot more flexibility. What are we doing mucking around with this yield curve?” [Laughter]

MR. VOLCKER. Well, we were mucking around with the yield curve. I remember, once a year, at the most twice a year, the New York Trading Desk made a big business about buying bonds. And I’d say, “What are we doing this for? We don’t trade in them!” [Laughter] The response was, “Oh, we have to keep the machinery of purchasing government bonds lubricated.”

MR. KOHN. Keep in touch with the market.

MR. VOLCKER. [Laughter] I was partly having fun. You remembered that?

MR. KOHN. Yes.

MR. VOLCKER. Anyway, it was important to my experience to have spent a year or two at the Trading Desk, because it was an exposure to markets. I got only a little bit involved in markets other than government securities. I didn’t do much actual trading. In the official view, I was too young and inexperienced. I would do it for customers but not for the Open Market Account, because everything depended upon your tone of voice and how you said things. When you first talked, they didn’t know if you were buying or selling, because sometimes you didn’t want them to know whether you were buying or selling. But I got to know some of the senior market people who were talking to me because I was at the Federal Reserve. It was an important part of my experience because of that.

MR. KOHN. With this stint at the New York Fed, what was your perception of the Board of Governors and this age-old rivalry?

MR. VOLCKER. The Board didn't understand markets. It was kind of distant. It wasn't in touch with the real world as much as it should have been.

MR. SMALL. Was the Board more academic or more formal?

MR. VOLCKER. It was certainly more academic and kind of out of touch. J. Dewey Daane was a frequent visitor, but he wasn't at the Board.¹² He was down at—

MR. KOHN. Richmond.

MR. VOLCKER. I have visited him several times. I told him, "Dewey, you retired four times." [Laughter] Charles M. "Charlie" Walker was another frequent visitor. These visitors were all fascinated and wanted exposure to the Trading Desk. But I don't remember anyone from the Board ever coming. The other Reserve Banks were sort of our allies.

MR. KOHN. When I came to the Board in 1975, there was a program of taking economists from the Board and from the Reserve Banks and circulating them through the New York Fed Desk for a week, especially if you were at a Reserve Bank when your president was going to be a voting member of the FOMC.

MR. VOLCKER. Was it 1975? Must have been when I was president of the Federal Reserve Bank.

MR. KOHN. It must have been.

MR. SMALL. When you were at the New York Fed early on, what was the state of reading the economy and forecasting? How far out did policymakers look?

¹² J. Dewey Daane was a Governor of the Federal Reserve from November 1963 to March 1974. Mr. Daane began his career working with the Federal Reserve Bank of Richmond, rising to vice president and director of economic research. He also served with the Treasury starting in 1960, including the post of undersecretary for monetary affairs before being appointed by President Kennedy to the Federal Reserve Board.

MR. VOLCKER. It was a big part of the domestic research. I remember Bob Lewis, who was the principal forecaster. Frank Schiff, a senior economist, and I used to do it sometimes. Maybe Al Wojnilower got involved. Two or three of us regularly forecasted the economy. I'm not sure how far we went ahead, but we certainly went a year ahead. We had a spreadsheet and fiddled around with the numbers. We would say, "This is what the historic pattern is" and "Inventories are getting out of line." We had all kinds of models for automobile sales based upon the life of automobiles. There was a big sales year in 1946. That meant that seven years later there would be a big replacement demand. I don't think the forecast was very reliable.

MR. SMALL. On the price side, you followed unions and wage settlements?

MR. VOLCKER. Well, in those days we used to think 2 percent inflation was excessive. We made a lot of speeches about it, but I don't remember many forecasts about it. I was at the New York Fed in 1949 and 1950. We had some inflation, but I wasn't doing any forecasting then.

MR. KOHN. When you went to the FOMC meetings those couple of times as a junior staff member, how would you characterize the discussion? Was it generally the same sort of thing we do today?

MR. VOLCKER. I remember these guys from Kansas and some other midwestern states kept talking about the subsoil moisture. Subsoil moisture didn't excite me. I realize now it's more important than I thought.

There was a similar kind of go-round. The seating was different. Martin would sit in the middle of the table on the side.

MR. KOHN. Middle, on the side? That's what we're doing now. Ben Bernanke sits in the middle on the side.

MR. VOLCKER. I suggested doing that, but I got voted down by the Board when I was there. Martin sat in the middle, and the Vice Chairman of the Board was on his left—the same now?

MR. KOHN. Same. That's what happens now.

MR. VOLCKER. I guess the Board Secretary must have been sitting in.

MR. KOHN. Yes, there is an assistant secretary.

MR. VOLCKER. The other Board members were directly opposite him, and the Bank presidents were in the other seats on the outer ends.

MR. KOHN. Now the Board members are down to the left, and the Bank presidents are arrayed on the ends. The staff is directly across.

MR. VOLCKER. That's a big change for the Federal Reserve. [Laughter] It may have only been once that I did it, not more than twice.

MR. KOHN. In the 1950s, there were several recessions: 1953–54, 1957–58, and 1959–60. In that context, how was the Fed viewed, in terms of conducting monetary policy? Was this something that the Federal Reserve should have prevented? Or were these recessions necessary to keep the inflation rate below 2 percent? How was the discussion?

MR. VOLCKER. I don't think either of those was actively debated. I didn't have a bird's eye view—only a mouse's eye view of things at that point. Recessions came along. They weren't considered something you could prevent or head off. There were some thoughts like that, of course, but the recessions weren't pleasant.

MR. KOHN. I suppose, having come through the Great Depression, a recession was not a big deal, as long as it was limited.

MR. VOLCKER. Recessions were fairly frequent. They were largely inventory recessions. It was just taken for granted that you were supposed to have price stability. The Federal Reserve made speeches, at least the New York Federal Reserve people made speeches: "The inflation rate is getting too high. It's 2 percent. It shouldn't be that high." Certainly, no one was sitting there saying, "It should be 2 percent," that's for sure. [Laughter] I don't know quite what it was. I think it was, on average, around 2 percent or less.

MR. KOHN. I think you're right. It was 2 percent and under most of the time. It averaged in the 1's.

MR. VOLCKER. When it got up to 2, we'd make speeches about it.

The only thing I would add is that the New York Federal Reserve Bank in those days was a terribly bureaucratic institution. I didn't know how bureaucratic it was, because that's all I knew. I hadn't been anywhere else. The president would ask a question. It would go to the vice president, to the assistant vice president of the Reserve Bank, and eventually it got down to you if it was in your area. You wrote a memorandum. It would go to your manager. It would go to the assistant vice president. It would go up to the president, and he might write a little note on it, which would come down to you. You never saw the guy.

At Chase Manhattan Bank

MR. KOHN. So you went to Chase in 1957.

MR. VOLCKER. I went to Chase.

MR. KOHN. Was Chase not as bureaucratic?

MR. VOLCKER. No, it wasn't. That was surprising, because it was a big organization. It depended on what department area you were in. I remember, the president once asked me to do something. I remember working fairly hard over the weekend. He called me to his office and said, "Sit down. I want to talk about the business outlook." [Laughter] The president of the Federal Reserve in New York never asked me for my view of the business outlook.

In those days, you didn't hire a black person, or you certainly didn't hire a Jewish person in those institutions unless it was a Jewish institution. Chase was an exception. There were a lot of Jewish people in the research department but not in the rest of the bank.

I remember being exposed to the head of the international department. He had great prestige for being the international head of the biggest bank in the United States. And to his subordinates, it was like seeing the prince. They would walk in and kind of back out. [Laughter] I don't remember it elsewhere except in that particular department, but that was almost literally true.

MS. FOX. Who recruited you to Chase? Who offered you the job at Chase, or who got you to leave the New York Federal Reserve Bank?

MR. VOLCKER. There were two very active guys running Chase's economics department then. They were pretty good economists, but they liked to write, and there was competition among the banks in writing their monthly reports. I don't know where they heard of me, but they persuaded me to get out of the dull old Federal Reserve.

I had had some interesting times at the New York Fed—the "bills only" thing. Roosa wrote a little red book then about how open market operations worked, and I worked closely with him on that book.¹³ We'd meet some government security dealers before 10:00 a.m., when

¹³ See Roosa (1956).

the market opened. But, day after day, I would sit at the Trading Desk, and the markets were not doing anything. Roosa would call and say, “What’s going on?” It got boring after a while. And you didn’t have any real authority. So it was time to get out and get some fresh air.

MR. KOHN. At Chase, were you writing this monthly report?

MR. VOLCKER. My main job was working with the people on the securities side. I did business and financial forecasting, including interest rates. My principal responsibility was to develop a “budget” for how many loans we could make this year, next year, or in the next six months. You were constrained by how many deposits you could raise. There was an interest rate ceiling. The negotiable CD (certificate of deposit) or the Eurodollar market did not exist.

MR. KOHN. Not until the early 1960s, right?

MR. VOLCKER. Yes. I went to Chase in 1957. The Eurodollar market may have just been starting, but it wasn’t significant. You had to make the projection of what resources the bank was going to have. How liberal could you be in lending? I sure wasn’t controlling this, but my reports went into some thought processes in the bank about how to conduct security operations and loaning operations. I worked pretty closely with the trading desk at Chase. So I got more exposure to the market.

I had a big break, as it turned out. There was a major private commission on money and credit. David Rockefeller was on the commission, and I became his assistant. I used to go to the meetings, and, de facto for a while, I was part of the staff of the Commission on Money and Credit.¹⁴ I got to know Marriner S. Eccles, who was on the commission.

¹⁴ The Commission on Money and Credit was established in 1957 by the Committee on Economic Development. Its objective was “to appraise our monetary and financial system, both public and private, and the governmental regulations and controls that affect it.” (See the foreword in any of the works from a series of research studies by Friend, Minsky, and Andrews (1964) for the Commission on Money and Credit.) The commission members included those associated with financial institutions, labor unions, and the business community.

MR. KOHN. The commission produced a series of studies.

MR. VOLCKER. It was a big report. There was a lot of controversy about the Federal Reserve around the time of the Treasury–Fed Accord. There were two big hearings: the Patman hearings and the Douglas hearings.¹⁵ The question was, basically, how independent the Federal Reserve should be. The current issues of monetary policy, debt management policy, and fiscal policy at that time were strongly debated. Fortunately, Senator Douglas was a defender of the Federal Reserve; Representative Patman was not. I think Allan Sproul, in his testimony—not William Martin—made up the phrase “The Federal Reserve is independent within government.”

MR. KOHN. I think I read that it was Allan Sproul.¹⁶ Were bankers part of the Commission on Money and Credit? What was Chase’s involvement?

MR. VOLCKER. David Rockefeller was the most prominent banker. The Chairman of the commission was Frazer B. Wilde [from Connecticut General Life Insurance Company]. In those days, the heads of these banks and insurance companies were all vocal. Many of them were leading statesmen or considered themselves as such, and they got involved in public policy. Nowadays, they are busy making zillions of dollars. And the banks are so active that it’s very different. Investment banks were small in those days; the banks themselves were small compared to what they are now. I think, when I went there, Chase had \$5 billion in deposits. You forget how small things were back then. Citibank, Chase, and Bank of America were about the same size. Gabriel Hauge, the head of Manny Hanny [Manufacturers Hanover Trust Company] at that time, was very prominent in public policy. Citibank was always much more

¹⁵ As chairman of a subcommittee on the Joint Committee on the Economic Report, Senator Paul Douglas presided over hearings on money, credit, and fiscal policy in the late 1940s and early 1950s and played an important role in supporting the independence of the Federal Reserve (Meltzer, 2002, pp. 685–90). As chairman of a subcommittee of the Joint Economic Committee, Congressman Wright Patman held hearings in 1952 on monetary policy and the management of public debt, focusing on the role of the Federal Reserve since the Treasury–Fed Accord (p. 715, note 239).

¹⁶ Bremner (2004, p. 90) attributes the saying to Sproul, as does Kettl (1986, p. 76).

aggressive than Chase. The personality of that institution hasn't changed. I was at Chase from 1957 to 1961. I went to Treasury in 1962, then I went back to Chase from 1965 to 1968.

My title at Chase during the latter period was director of forward planning. If somebody asked me some question like, "What does the director of forward planning do?" I would not be very diplomatic. I said that I should be looking at the paper to see what Citibank did yesterday. [Laughter] The whole attitude at Citibank was, how do you get around regulation? But I think Charles O. "Chuck" Prince has tried to change the culture. How do you get as close as you can to breaking a regulation without actually being called up on the carpet? If you were called up on the carpet, scream like heck. Chase had exactly the opposite attitude, which I think cost it competitively. I got to know Chase's principal outside lawyer very well; he was a wonderful guy. He was older than I and took me under his wing. He always said, "Play with, don't fight the Federal Reserve. Don't fight the authorities. That's part of being an American, part of being a responsible banker." All of these innovations in banking started with Citibank.

Chase had a great credit training program. I don't think they have any credit training program anymore. The whole culture of Chase was that people come up through the credit program. I was never quite fully accepted, because I didn't come up through the credit program. They had a real coterie of people. The credit training was a two-year program. You went to school every day for the first six months. Then you would be sent around the bank. It was a strong program. George Champion, the chairman of Chase, used to sit there and say, "How can Citibank send these people down to Latin America when they haven't had any training, for God's sakes? They're going to get the bank in trouble!"

MR. KOHN. And they did.

MR. VOLCKER. I saw a friend—at Citibank now—and I said, “I told you it wouldn’t work.” [Laughter]

From Chase Manhattan Bank to the U.S. Treasury

MR. KOHN. How did you get to Washington, D.C.? What’s the story about the transition from Chase to the Treasury Department?¹⁷

MR. VOLCKER. Roosa became undersecretary for monetary affairs at Treasury. In those days, that was a very important position. He got this idea—not a very good idea—that you ought to set up a unit in the Treasury to do longer-term economic research. So he got me to come to Washington to head up this office, and we hired a couple of people. A governmental agency is not very hospitable for doing long-term research, because the pressures are on tomorrow, not what’s going to happen 10 years from now. Do you know [Samuel B.] “Sam” Chase?

MR. KOHN. Very well. Was he part of that group?

MR. VOLCKER. He was part of this group. Herman Liebling, an economist in the Budget Bureau from the old, nonmathematical school was the chief forecaster. Also, David J. Meiselman was on the staff. And Allan H. Meltzer, who had been a consultant to Treasury outside this group, was kind of involved, but he wasn’t actually on my staff. There was one other person.

Dewey Daane was at the Treasury before me. He became friendly with Roosa. He was Roosa’s deputy undersecretary. Dewey went to the Board, and then I took his job after being director of the Office of Financial Analysis. I hadn’t been there very long before, de facto, I was

¹⁷ After working at Chase Manhattan Bank since 1957, Paul Volcker was director of the Office of Financial Analysis in the U.S. Treasury from 1962 to 1963. He was deputy undersecretary for monetary affairs from 1963 to 1965.

the principal policy assistant of Treasury Secretary C. Douglas Dillon. I used to write his speeches. I was his chief economist over time. When Roosa left, not long after I became his deputy undersecretary, Frederick L. “Fred” Deming from the Minneapolis Fed took his place.

That wasn’t the greatest time in my life, but it was exciting. It was the Kennedy Administration; we were going to reform and heal the world. I remember writing a memorandum in support of the Kennedy tax bill, which had been a big fight between the Treasury and the Council of Economic Advisers. The council wanted a quickie tax cut. This was in mid-1962, and there was fear of a recession. There was a hullabaloo about steel and steel prices: “We have got to have a tax cut—cut off this imminent recession!” We had Troika meetings, and we had joint economic forecasts.¹⁸ My economic forecast was that we were not going to have a recession. And we didn’t.

Dillon wasn’t eager about a quick and simple tax cut. His philosophy was, we’ll have a tax reduction, but it’s going to be done by the Treasury, and there’s going to be tax reform at the same time. So a lot of emphasis was put on tax reform as well as tax reduction. I remember the day Dillon testified to present this bill on the Hill and was attacked endlessly about the reform part: “You mean you’re going to remove the mortgage interest deduction, et cetera?” I don’t know what all was involved. He got a barrage of criticism about that. He used to eat with six or seven people when he was in town in his private dining room, which he subsidized! When he came back from testifying on the Hill, he sat at the table, and a guy named Harvey E. Brazer—

MR. KOHN. Harvey Brazer was at the University of Michigan when I was there.

¹⁸ The Troika was a group of presidential economic advisers consisting of the Chairman of the Council of Economic Advisers, the Secretary of the Treasury, and the Director of the Bureau of the Budget. The Quadriad consisted of this group plus the Chairman of the Board of Governors of the Federal Reserve.

MR. VOLCKER. Harvey Brazer was a great tax expert. He was working in particular on all this reform stuff. Dillon said, “Now Harvey, this tax bill of yours.” [Laughter]

Anyway, I had written a memorandum which only I remember. It was a long analysis of why this tax bill was a good idea, saying, “Given the particular situation that exists now in the economy, the net result should even be an increase in government revenue.” It included the multiplier effect. Investment was low—strictly a Keynesian analysis. You were going to trigger off an accelerator, and, under the circumstances, it might even be possible that the tax deduction increased revenue.

MR. KOHN. We’ll rename it the Volcker curve.

MR. VOLCKER. It wasn’t that kind of curve. It was strictly a Keynesian multiplier/accelerator.

MR. KOHN. On the Treasury–Fed relations in the early 1960s, there was Operation Twist and some of the reactions to the international pressures on the dollar.¹⁹

MR. VOLCKER. In those days, I was on the fringes of the international side. I was much more on the domestic side when Roosa was there. When I was deputy undersecretary, then I got both. It’s hard to re-create the atmosphere, but the \$35 gold price was sacred—a matter of international commitment and credibility—and you couldn’t talk about changing the exchange rate of the dollar. It was as if now we were talking about some great symbol, like a treaty obligation. If you wanted to say something about the exchange rate, you had to take people off in the corner and not admit your views to everyone else when the subject would come up.

¹⁹ Under Operation Twist, the Treasury and the Federal Reserve attempted to “twist” the yield curve of Treasury interest rates—raising short-term interest rates and lowering long-term rates—by selling Treasury bills and purchasing Treasury bonds. The rationale was that financial capital outflows from the United States would be mitigated by higher short-term rates, while domestic investment would be supported by lower long-term rates.

I wasn't that close to it, but I had the impression at the time that the Treasury was in favor of tighter money—more so than the Federal Reserve. At some point, the dollar was under pressure, which would have been reflected in a gold outflow. Money and capital were flowing out. My impression was that the Treasury was pressing the Federal Reserve to raise interest rates, and Martin wasn't very eager to do that. Finally, he agreed to do it. I wasn't involved in the discussion, and he was going to have a press conference to announce it. This would be when the Fed changed the discount rate, probably in 1962 or 1963. I was told, "You go over there and listen to the press conference and make sure Martin gets the story straight." [Laughter]

MR. KOHN. What were you supposed to do if he didn't?

MR. VOLCKER. [Laughter] I don't know. Anyway, the Treasury wanted a direct report on how the press conference was handled or if Martin was sufficiently enthusiastic. Against the earlier background of fighting with Martin over "bills only," Roosa became a great supporter of Martin's, pushing actively for his reappointment. Martin [laughter] wasn't as enthusiastic about Roosa, but he was certainly friendly.

MR. KOHN. The only time I had an extended conversation with Roosa was at Jackson Hole many years ago. I asked him about Operation Twist, and he said that he had been at an OECD (Organisation for Economic Co-operation and Development) meeting. There were capital outflows and pressure on the dollar, and he had been catching a lot of flak. On the way back in the airplane, according to him, he had this idea that we could raise short-term rates and lower long-term rates to encourage investment. I said, "So when you got back, what did you do?" He said, "I talked it over with people at the Treasury. We went across the street and talked to Jack [John F. Kennedy]." I said, "When did you tell the Federal Reserve?" This was during the Reagan Administration that I had this conversation with Roosa, and, in my mind, I had

trouble imagining that conversation happening. When I asked, “When did you inform the independent Federal Reserve?” Roosa said, “Well, after we had Jack’s clearance.”

MR. VOLCKER. The President of the United States had to approve every individual bond issue in those days. Every time you issued bonds, you had to prepare a little memorandum on why we were doing that and get his approval. It was sort of a routine, but not entirely. You had to make sure his staff got the memorandum to him. Kennedy was concerned about the dollar, and his father had told him it was a great vulnerability. Walter W. Heller was very close to him, so he was getting harangued by Walter and his CEA colleagues on economic and financial stuff all the time. They were less dedicated to the international defense of the dollar.

MR. KOHN. At some point, there was a Quadriad formed within the Administration, which had the Fed as well as the three pieces of the Administration.

MR. VOLCKER. If my memory serves me, there was a Troika in some nascent form when I was first in the Treasury. The Troika existed before the Quadriad, but I don’t remember how much before. The Troika would meet without the Federal Reserve but once a quarter would meet with the Federal Reserve, with Martin. The story of one of these meetings of the Quadriad is in the biography of Martin.²⁰

Henry H. Fowler became Secretary of the Treasury. For some reason, I got very close to Fowler. And I was closer to Fowler than I realized at the time [laughter], at least in his mind. I don’t know where Frederick L. Deming, the undersecretary, was. But Fowler took me to meetings occasionally with Lyndon B. Johnson—part of my education. I didn’t play any part in these meetings except sit there. The first time I went, a dog had laid down alongside Johnson’s rocking chair, and every time Johnson would rock, he would get an eighth of an inch closer to

²⁰ See Bremner (2004, pp. 209–11).

the dog's tail. I was wondering what would happen when he finally hit the dog's tail. The rocking chair got about half an inch away, and the dog moved his tail. [Laughter] That is my great memory of Johnson.

Anyway, this is in 1965. I'm confused about the exact timing of this, but I'm not confused about the event. Fowler was Secretary of the Treasury. My memory is, as early as September, Martin took the position, "We've got to tighten policy. Things are getting out of hand." Fowler was very much opposed. This went on for some weeks. Martin kept saying he wanted to move the discount rate by a half of a percent. I thought it was a good idea, but my boss, Fowler, thought it was a terrible idea. [Laughter] At one point, I said to Fowler, "A quarter would be okay, wouldn't it?" But he didn't agree! Anyway, there was a big dispute. At some point along the line, there was a memorandum written by Arthur M. Okun, Daniel H. Brill, Charles J. Zwick, and me.²¹ It was not my high point. The orders were, "You subordinates give us a recommendation, if you can agree."

MR. KOHN. On the interest rates?

MR. VOLCKER. Or on the economy, but interest rates were the key issue. It's the same thing. It was odd, because Martin appointed Dan Brill to the group, and Dan Brill was dead set against raising interest rates.²² I never understood Martin—he just didn't care, or what? Dan openly thought raising rates was a bad idea. I was the Treasury guy, but I thought it was a good idea. I wasn't so open about it out of loyalty, but I thought it was a good idea. So the Treasury staff guy would support it, but the Federal Reserve staff guy did not.

²¹ See Volcker and others (1965).

²² Daniel H. Brill was the director of the Division of Research and Statistics at the Board of Governors of the Federal Reserve [from 1964 to 1969].

Anyway, we wrote this memorandum, which I'm not very proud of. It said, "All things considered, based on what we know now, we ought to wait until January to make this decision on raising interest rates, and then it could be aligned with the budget." I think I got a footnote in there to the effect that if, however, defense spending is rising as fast as some people think, we should probably do it earlier.²³ You can go back and read what the footnote said. The memo became public. That footnote in my head is in there. Whether it is actually in there or not, I don't know. Anyway, they called this Quadriad meeting. I didn't say a word. Fowler introduced the subject. He said, "Chairman Martin thinks it's necessary to raise interest rates." Johnson interrupts him and says, "You mean he wants to extract more blood out of the American people?" [Laughter]

MR. KOHN. Was Martin sitting there with you?

MR. VOLCKER. Yes, Martin was sitting right across the table. Martin says, "Yes, sir." They went back and forth, and Martin was still sitting there saying he wanted to do it. Finally, Johnson said, "Bill, I'm going in the hospital to have my gall bladder removed. You wouldn't do this while I'm in the hospital, would you?" Martin said, "No Mr. President, we will not do it while you're in the hospital." [Laughter]

I talked to Dewey Daane the other day. He said that a few days later, when Martin was going to have a vote of the Board, it wasn't clear that Martin had the votes. Daane says he was the swing vote and finally decided that he had to vote for the increase. What I don't understand about this is that, for at least two months, Martin had been telling Fowler he wanted to do this,

²³ "The most striking possibility for an advance significantly more rapid than our forecast lies in defense expenditures. The current projection supplied by the Bureau of the Budget calls for a \$4 billion increase in the rate of federal purchases from 1965-III to 1966-II. If, however, federal spending rose much more rapidly, we would expect a significant and undesirable acceleration in the pace of overall economic activity. But, barring a new or sharply intensified international emergency, this does not seem likely" (Volcker and others, 1965, p. 2). "The uncertainties in the defense area depend in considerable measure on Vietnam" (p. 7).

and he was telling Fowler without knowing that he had the votes on the Board? It seems strange, because I'd remember any indecision on Martin's part that he wanted to get this done. I never had any feeling that there was a question. It didn't even occur to me. Dewey's story is so clear in his mind it must be true. Dewey was torn, because he was close to Martin, but he thought he owed his appointment to the Administration, and crossing the Administration posed a great conflict.

I still don't understand how Martin could have been pressing that hard, that long, without being sure that he had the votes from the Board. Maybe he thought he had them, and when push came to shove, he didn't. I don't know who was all on the Board at that point.

MR. KOHN. Coming to the Administration for permission to raise interest rates strikes me as not a great idea, among other things.

MR. VOLCKER. Well, Martin wasn't really asking for permission, and this has obviously varied over the years. I know of two different sets of professors reading Nixon tapes—which is an endless thing—to get economic stuff. I tell you, I have new sympathy for Arthur Burns when you understand the pressure he was under at times. From my viewpoint, it's kind of a distorted picture, because the transcript has these comments with Nixon talking with his advisers and berating Burns and so forth. But the whole context is missing. But Johnson really would berate. [Laughter] Boy, it was known at the time.

MS. FOX. When did you first know Arthur Burns?

MR. VOLCKER. When I first went to the Federal Reserve in 1949, my little desk, which was in an open area, was next to Herb Schwartz's desk.²⁴ Herb Schwartz was Burns's brother-in-law. He would tell me what a great man Arthur Burns was. Burns wrote this booklet

²⁴ Herb Schwartz was a statistician and was one of the founders of the Downtown Economists Club of New York City.

Economic Research and Keynesian Thinking of Our Times. It was an attack on Keynesianism. I have no specific memory of having first met Burns. I think I had a handshake or something. It must have been when he was counselor to President Nixon, before he was Chairman of the Federal Reserve, that I had direct dealings. I was an undersecretary at the Treasury, and we met on some occasions then. He was waiting to get appointed. This was at the start of the Nixon Administration. As undersecretary, I had an interest in dollar policy, obviously, and exchange rates and all the rest. There were all kinds of rumors that, before Nixon's inauguration, Burns was going around visiting the foreign treasuries and central bankers. I don't know what he said, but the story was that he was canvassing what they thought about raising the gold price and devaluing the dollar, which was anathema to me.

When I was Chairman of the Federal Reserve Board, in the interregnum between Carter and Reagan there was some conclave of Republican economists in California talking about how they were going to take over economic policy and other things. Apparently, number one on the agenda was taking over the Federal Reserve. Burns was a leading Republican economist, and he was invited to this meeting. He flew back to Washington, invited me back to his apartment, and told me about this meeting. I thought he was going to have a stroke. [Laughter] As he was telling me the story, he was upset because they were all attacking the Federal Reserve and talking about how they were going to introduce legislation and when they should do that. Milton Friedman and Bill Simon were leading the parade. Nobody else argued against it except Burns. The other people sat around there and were perfectly silent with this attack on the sacred institution of the Federal Reserve. Burns flew back to tell me what I was up against. He was really upset.

MR. SMALL. You mentioned Martin, the discount rate increase, and the uncertainty about the increase in defense expenditures for Vietnam. Do you think that was the point where inflation took hold and took off, or did it start earlier?

MR. VOLCKER. I don't think it had taken hold at that point, but it was a concern. I had left the Treasury between the time of the meeting with President Johnson's gall bladder comment and the time Martin actually did raise rates a week or two later. I knew I was leaving the Treasury.

Around that time—I was a great admirer of Martin; he was my hero—I wrote him a memorandum laying out what I thought should be done. You had to have a tax increase. The discount rate thing had been done. I wasn't alone in thinking how important this was to maintain credibility in the economic policies—basically, the Keynesian economic policies. The time had come not to reduce taxes, but to raise taxes and get the budget in shape or we were going to be betraying the great legacy of the early 1960s.

H. Gardner Ackley was the Chairman of the Council of Economic Advisers, and I think he shared this view. I think the Council of Economic Advisers wanted to increase taxes. I didn't think Fowler supported that. President Johnson didn't want to raise taxes. He said, "This will be a referendum on the Vietnam War, and I don't want a referendum on the war." There may have been other reasons, too. Fowler certainly supported that line; what he believed himself, I don't know.

MR. SMALL. Was there much to the argument that, back then, people didn't really understand the costs of inflation, but by the time you came in as Chairman of the Fed, they did?

MR. VOLCKER. Oh, no question about that. There was some difference between being worried about inflation going from 2 percent to 3 percent and going from 12 percent to 13 percent. [Laughter] There was some worry about it, but it hadn't hit the public.

Becoming Undersecretary at Treasury

MR. KOHN. So you left the Treasury Department, went back to Chase, and then came back to the Treasury Department—in what year?

MR. VOLCKER. It was 1969, at the beginning of the Nixon Administration.²⁵

MR. KOHN. What brought you back?

MR. VOLCKER. I don't know for sure. I should know. I got bored at Chase. The decision took about two seconds, but why I got asked, I don't know. I have read—and I guess it's true—that, at that time, I was not a hidden Democrat. I was the Plainfield, New Jersey, treasurer of the Kennedy for President Committee.

Anyway, I knew Charlie Walker; I had known him for years. He had been the head of the ABA [American Bankers Association], and I had done some stuff with the ABA. I think Charlie Walker was picked as undersecretary of the Treasury by David M. Kennedy. One story—which may not be entirely true, but it's all I know—was that he pushed Kennedy to ask me. I knew David Kennedy for some reason, but I didn't know him well. He may have been on the Commission on Money and Credit. They wanted me to be undersecretary of monetary affairs, and that didn't go over well in the White House, I guess. There were a lot of other appointments to be made, and he insisted, which was unusual because he didn't insist upon much against White House wishes. [Laughter] I think Walker talked Kennedy into pushing it. David

²⁵ Mr. Volcker was undersecretary of the Treasury for monetary affairs from 1969 to 1974. He had been deputy undersecretary for monetary affairs from 1963 to 1965, after which he rejoined Chase Manhattan Bank as vice president and director of forward planning.

Kennedy must have thought favorably of me, too. He became Secretary of the Treasury and said, "This is what I want." So I got appointed. I think it was fairly early in January.

MS. FOX. Who called you about it?

MR. VOLCKER. I guess it was David Kennedy. He asked me to come to Washington to see him. We talked a bit, and he said, "We want to make you undersecretary." I thought it was just a meeting. But that's where my heart was, more than at Chase. There was no indecision in my mind.

I was sitting in my office on inauguration day even though I couldn't be sworn in. From my office, I could see the inauguration parade. During the parade, National Security Study Memorandum 7 arrived on my desk. National Security Study Memorandum 7 said, "We will establish a committee to develop international monetary affairs policy. The undersecretary of the Treasury for monetary affairs should be the head of the committee. Other people will be on the committee, and they will report to Assistant to the President Henry A. Kissinger."

I went running into Kennedy and said, "Hey, this is fine for me, but it doesn't look so good for you, and I don't want to be reporting to Henry Kissinger. You better go over and get this straightened out PDQ." But Mr. Kennedy was not much of a bureaucrat, and he didn't know what to do with National Security Study Memorandum 7. I don't think he ever did anything, to tell the truth. It was out of the blue that it arrived on inauguration day. Such a committee did exist. Maybe it started under Roosa, but certainly it was more formalized under Deming. I don't know if it ever had formal status before that memorandum. But there had been a committee headed by the undersecretary for monetary affairs before I arrived. I think C. Fred Bergsten on Kissinger's staff was probably involved in preparing the memo.

MR. KOHN. Was managing international issues your main task as undersecretary?

MR. VOLCKER. Yes. It was very much a crisis atmosphere. You just had the gold crisis and the separation of the gold market and all kinds of G-10 meetings. At that time, there was definitely a feeling of crisis internationally. That was the number one thing on the priority list. But I had a lot of things on the domestic side, too. It was the best job I ever had.

MR. KOHN. It was the best job because it ranged over so many different things?

MR. VOLCKER. Yes. I forgot about this. I started the auctioning of Treasury bonds. I don't know what's ever happened to the Federal Financing Bank, which didn't develop the way I wanted it to.

MR. KOHN. You once told me that was one of your great regrets.

MR. VOLCKER. Yes. We did control Fannie Mae in those days, before it got out of control. And there were others.

MR. KOHN. So that was a time when inflation had risen?

MR. VOLCKER. Well, we can talk about inflation. I can remember visiting Nixon, which I didn't do regularly. I was not alone. Shortly after the inauguration, Kennedy, Walker, and I had a formal visit with Nixon. Walker and I eagerly told him, "You're in here. The inflation rate is up. You've got a problem. Deal with it now. If you have to have a recession, take it early. Don't sit around, because it will be worse for you later. Make it a big priority of dealing with inflation. That ought to be your number one thing. The inflation rate is up to 5 percent. This ought to be a big priority." And he didn't believe a word. [Laughter] It didn't become his creed.

MR. KOHN. Well, there was a recession.

MR. VOLCKER. There wasn't that much of a recession, but the great disappointment was that the inflation rate didn't come down much. It would have happened anyway, but,

politically, that failure of inflation to come down set the stage for going off gold, and that politically and economically should have provided the setting for dealing with inflation. But going off gold didn't deal with inflation in the right way. We weren't dealing with inflation at all as it turned out, but going off gold was the cover for price controls and all that stuff. There were "the four no's."

MR. SMALL. No tax reduction, no increased federal spending, no wage-price controls, and no wage-and-price review board. This is from the appendix in your book.

MR. KOHN. Those were when?

MR. SMALL. June 26, 1971.²⁶

MR. VOLCKER. Yes. There's something screwy. When I was reading what the professors wrote after they listened to the Nixon tapes, they had all this much more compressed in time than I remembered. June sounds right to me. I think they had it, like, two weeks before August 15.

MR. KOHN. So Nixon gave his four no's?

MR. VOLCKER. John B. Connally; George P. Shultz, who was in the White House at the time; and McCracken had a meeting.²⁷ By this time, Connally was pressing for letting go of the gold standard. We had a big plan. I had developed a big briefing book—this minute-by-minute scenario of how to get off the gold standard—much of which got ignored. The central idea was that we would go off gold. We were worried about inflation. We would freeze prices for three months. Burns was all in favor of a price freeze—I don't think Burns was in this meeting.

²⁶ See Volcker and Gyohten (1992, p. 344).

²⁷ At that time, John Connally was the Secretary of the Treasury, George Shultz was the Director of the Office of Management and Budget, and Paul W. McCracken was the Chairman of the Council of Economic Advisers.

Anyhow, Connally had been discussing it with President Nixon, trying to bring him around on these big changes in economic policy. Out of this particular meeting, the order to Connally was to go out there, give a press conference, and say there will be no price controls, no this, no that, no the other thing. Connally loyally went out there and gave the four no's, even though he was not in favor of the no's. [Laughter] I don't know when, but shortly thereafter, Connally finally convinced Nixon he was going to have to do something. Nixon wanted to wait—that is in the Nixon tapes. He said, “I don't want to do this with Congress in recess.” Connally said, “Since you're not going to do it, I'll go on vacation.” He went to his beloved ranch. He was only there for three or four days when I called him and said, “This isn't going to wait!” [Laughter] So he came back, and that's when we went to Camp David to work out a plan.

MS. FOX. That was in August 1971?

MR. VOLCKER. Yes.

MR. KOHN. How important was Arthur Burns's Pepperdine speech saying incomes policy was acceptable?²⁸

MR. VOLCKER. I had forgotten about it, but I remember now. When was it?

MR. KOHN. I don't know the date.

MR. VOLCKER. For six months, Burns had been bugging Nixon to have an incomes policy. And Burns kept bugging me, because he wanted me to join him. Naively, I was in favor of the freeze. I didn't want to get involved in a big incomes policy but said, “You've got to do something to break the momentum of inflation expectations if we're going to raise a lot of inflationary questions and we need to devalue.” And I wasn't the only one. Burns and I were

²⁸ See Burns (1970).

allies in wanting to do something on the price side, administratively. Nixon got tired of hearing this from Burns all the time and stopped listening, I guess. If you listen to those tapes, Burns comes over as a hectoring lecturer. Nixon finally got sick of that. [Laughter]

MR. KOHN. The accusation has always been that Burns was doing Nixon's bidding and wasn't sufficiently tightening monetary policy because of concerns about the 1972 election.

MR. VOLCKER. I never gave much credence to that. Not that Nixon wasn't concerned about being elected. But you listen to the White House tapes and the berating by Nixon. Burns had to be influenced to some extent. Nixon was threatening to change the law governing the Federal Reserve. It may have been hot air, but nonetheless! Burns considered himself close to Nixon. Nixon appointed him, and Burns loved being appointed to the Chairman of the Federal Reserve. He got it pretty hot and heavy.

MS. FOX. Did you see the strain of dealing with Nixon on Burns in any particular way?

MR. VOLCKER. Well, I wasn't at the Federal Reserve then. I was anti-Burns at that time, in terms of both national and international monetary policy. As undersecretary of the Treasury, I was seeing all this pressure on the dollar. Even later, when the Bretton Woods system was breaking down, Burns would be sitting there, saying, "I don't want to do anything to the dollar." I thought, "Well, go home and raise interest rates"—[laughter]—"do something to defend the dollar."

MR. KOHN. So, as undersecretary, you saw the need for tighter monetary policies?

MR. VOLCKER. No question about that. I could not understand the Federal Reserve. One time I resorted to a direct appeal. I had to go to some international meeting when the dollar was under pressure, and I called Dewey Daane. He was in a Board meeting, and I thought,

“Darn it! Don’t let the Fed reduce the discount rate while I’m sitting in Paris talking to these guys about supporting the dollar.” [Laughter]

MR. KOHN. Why do you think Burns didn’t raise interest rates?

MR. VOLCKER. I now realize he was under a lot more pressure than I ever imagined. It’s not much fun raising interest rates. [Laughter] We had just been in a recession. When did you come to the Board?

MR. KOHN. I came here in 1975. I was at the Kansas City Fed in 1970.

MR. VOLCKER. This was before you were there. I remember that Burns brought [David C.] Melnicoff from Philadelphia to the Board. He had been an economist and became Burns’s right-hand man. I remember getting in an argument with him. I asked, “Why aren’t you moving—raising the discount rate, raising the federal funds rate by $\frac{1}{4}$ percentage?” He said, “It’s not like that makes a big difference anyway, and it creates a big problem. Why should he do it, blah, blah.” And that also was Burns’s argument. I think Burns was under a lot of pressure, and we had just come out of a recession.

MR. SMALL. On the transmission of interest rate increases to the economy, it’s often claimed that policymakers back then didn’t look at real interest rates, they only looked at nominal rates. On the other hand, interest rate ceilings were in nominal terms, so disintermediation would kick in when those nominal ceilings were hit.

MR. VOLCKER. There wasn’t a focus on real interest rates at the time, because there wasn’t an assumption you were going to have much inflation. The term “real interest rates” was certainly known, but I think that’s right, we didn’t think in those terms that much until the inflation had persisted for a while.

New York Reserve Bank President: 1975–79

MR. KOHN. So when you think about that whole period—from 1965 to when you took over as Chairman in 1979—and the general uptrend in inflation, political pressure obviously played a role.

MR. VOLCKER. You read Burns’s great benediction speech “The Agony of Central Banking.” He worked hard on that. I didn’t understand Burns. I had great respect for Burns as a business analyst and as a strong person and as adamant in his defense of the Federal Reserve, but he sure ran a loose monetary policy. Despite the fact I was arguing with him—I don’t know how many times I actually dissented when Burns was there—but I was consistently on the side of tighter monetary policy.²⁹ I must have been a burr under his saddle.

Nonetheless, he was so strong that he persuaded me that, when I left the Treasury, I had to accept the offer to be the president of the Reserve Bank of New York.³⁰ I had had no intention of becoming the president of the Federal Reserve Bank in New York. It was his sheer, dogged personality [laughter] that kept saying I had to do this. We were allies on some things, for sure. We were allies on price controls, which was a mistake.

MS. FOX. What was Burns’s argument for wanting you to go to the New York Fed?

MR. VOLCKER. I couldn’t figure it out. First of all, Arthur disliked and didn’t respect my predecessor, Alfred Hayes.³¹ No question about that. [Laughter] He wanted to get Hayes out of there. But Hayes didn’t leave until his formal term ended. He stayed until he was 65.

²⁹ Mr. Volcker dissented twice at FOMC meetings during Burns’s chairmanship. At the FOMC meeting of November 18, 1975, he dissented in favor of maintaining the current stance of monetary policy rather than easing policy. In the July 20, 1976, meeting, he dissented against widening the range for the federal funds rate. In both cases, he preferred to maintain the current stance of policy as indicated by the federal funds rate and not to have the funds rate vary in response to, possibly temporary, changes in the monetary aggregates.

³⁰ After leaving the Treasury in 1974, Mr. Volcker was a senior fellow at the Woodrow Wilson School of Public and International Affairs at Princeton University for the academic year of 1974 to 1975 and was President of the Federal Reserve Bank of New York from August 1975 to August 1979.

³¹ Alfred Hayes served as president of the Federal Reserve Bank of New York from August 1956 to August 1975.

MR. KOHN. So did you want to become president of the New York Reserve Bank?

MR. VOLCKER. No. At that point, I had been in the Treasury for five years. I thought it was a great job, but we had Watergate, which was very unpleasant. I didn't like working for Nixon after Watergate. And I certainly didn't want to stay in the Treasury under William E. "Bill" Simon. I wanted out. I thought it was time. When you get out of these bureaucracies, it's like, "Yes, I can breathe again," or, "I can say something."

I had some very good opportunities. I could have become a partner of Goldman Sachs. [Laughter] I had made up my mind where to go, but it wasn't Goldman Sachs. Burns kept pushing and pushing. And I had to give an answer finally. I remember picking up the telephone on my way to a salmon fishing trip. I could not resist his forcefulness. [Laughter]

MS. FOX. You were at the Treasury Department when George P. Schultz was Treasury Secretary, and you left as William E. Simon was coming in as Treasury Secretary?

MR. VOLCKER. I left as William Simon was coming in. I had been there for five years, which was a long time. My first instinct with Watergate is, "What am I doing here? I want to get out of here." But I was in the middle of a big international negotiation. We were going to reform the international monetary system, and I was going to lead the reform. That didn't work out, but I couldn't very well resign in the middle of all that. I was ready to go, and it had nothing to do with economic policy. It was 1974. Maybe it had something to do with the school year, but I was ready to leave. When did I leave?

MR. KOHN. 1975?

MR. VOLCKER. In 1974, whether the timing to leave the Treasury was tied to the school year or not, I don't know. My wife was bugging me to make up my mind. I remember that I went home one day and told my daughter that I decided to stay another year. She burst out

crying. [Laughter] She had just graduated from high school, Sidwell Friends, and she was going to Georgetown University. I didn't realize that in going to Georgetown, she wanted the family to get out of town. [Laughter] This was clearly in her mind! She was going to be free of the family. [Laughter]

MS. FOX. William Simon became deputy secretary of Treasury in 1973, and in 1974 you went to Princeton and Simon became Treasury Secretary.

MR. VOLCKER. I left Treasury in 1974.

MR. KOHN. So you were at Princeton when you went to the New York Fed.

MR. VOLCKER. Yes. I went to Princeton because Hayes was still president in New York. The idea was that Hayes would leave, but Hayes wouldn't leave. I don't remember when I knew that, and the forsythia were out. I said, "What am I doing, screwing around? Why don't I go to Princeton for a year?" I had forgotten how miserable it is in the winter in the slush and the snow and the cold.

MR. KOHN. When you came back to the Federal Reserve (the Federal Reserve Bank of New York) in 1975, inflation must have been the primary focus. Arthur Burns was still the Chairman. So you found yourself fighting this fight. Did you have allies on the Committee?

MR. VOLCKER. Yes. Mark H. Willes was the big hawk. I don't remember Henry Wallich taking a strong line. He must have. Several of the Reserve Bank presidents were restive, and there were quite a lot of dissents at the time. I never dissented on what I saw as the fundamental stance of monetary policy when Burns was there.³² I waited for Miller to become Chairman. I remember being approached by a couple of the presidents, saying, "You've got to dissent, otherwise Burns will never change."

³² See note 29 for more information on Volcker's dissents.

I was going to stay in the Federal Reserve System for five years, because you got a special pension deal from which I still benefit. If you became a president of a Federal Reserve Bank and came from outside the Federal Reserve, they would give you a pension of 40 percent of your salary if you stayed for 10 years. I knew that existed and said, "I want to make this pension deal. I've worked in the government a long time, and I am entitled to something anyway. You make it five years." That was more important to me than the salary. The Board agreed. But later, when I was already in office, they said, "We thought about this pension thing. That would be something special, and we don't want to do that." I said, "You agreed. I took the job. If you renege, I resign tomorrow." [Laughter] In the end, my pension was slightly higher than it would have been.

MR. KOHN. Through the 1970s, there was increasing discussion of the money supply. Did you see that even before you took over?

MR. VOLCKER. Yes, I had made some speech that gets quoted. It's called "Practical Monetarism;" I think that was the speech.³³ I was looking for something. How do we get out of this rut with nobody taking a forceful enough approach toward inflation? It was vague, but it was something like what we finally did. We had to somehow pay more attention to the money supply.

MR. KOHN. This was a speech you gave while you were at the New York Fed?

MR. VOLCKER. Yes. I was frustrated, because the inflation rate kept going up and nobody stopped it. There was no discipline. We needed a way to get some discipline in the system.

MR. KOHN. Did the choice of William Miller to replace Arthur Burns surprise you?

³³ For an early use of the term "practical monetarism" by Paul Volcker, see Volcker (1976; also see 1977, 1978).

MR. VOLCKER. I don't think I had ever heard of Miller before he was picked. Frank Morris told me that Miller was a great fellow.³⁴

I told you that I got turned down twice from jobs with the Federal Reserve. After I had been deputy undersecretary of the Treasury and I was back at Chase, the presidency of the Federal Reserve Bank of Boston became open. There were two names under consideration, mine and Frank E. Morris's. Frank Morris was an officemate of mine when I first went to the Treasury. He was my best Washington friend. We worked together, and our families knew each other. I agreed to be interviewed. I knew I wasn't making a good impression during the interview, because my heart wasn't into it. [Laughter] I knew Frank was the other guy. My life's ambition was not to become president of the Federal Reserve Bank of Boston, although I thought that was a good job. Even then, the Federal Reserve Bank of Boston had a distinct role. Minneapolis did, too, but Boston had a stronger connection with its own District than any of these banks did.

MR. KOHN. Certainly with the academic community.

MR. VOLCKER. Right, the academic community too. It was a very prestigious position in Boston, partly because it was in New England, and New England had a strong regional feeling. George H. Ellis was president of the Boston Federal Reserve Bank before Frank.³⁵ So it wasn't a bad place to be. But from the standpoint that I had been deputy undersecretary of the Treasury, thinking I was helping to run the world, president of the Federal Reserve Bank in Boston didn't especially appeal to me.

MR. KOHN. What was your perception of the Board staff's work through the 1970s?

³⁴ Frank E. Morris was president of the Federal Reserve Bank of Boston from August 1968 to December 1988.

³⁵ George H. Ellis was president of the Federal Reserve Bank of Boston from March 1961 to June 1968.

MR. VOLCKER. The Board was a good, stable institution with fine and respected economists, but it was kind of stuffy. It was not very imaginative, not very quick on its feet. There was always something more to be studied. This was from a Treasury perspective that was much more informal in its hierarchy and everything else and seemingly quicker to act. It was different. The Federal Reserve Board has a Chairman. Just having a Board makes it inevitable that it's not so quick on its feet. [Laughter]

MS. FOX. What about the culture at the New York Fed? You had been a summer intern there early in your career, and then you went back as president.

MR. VOLCKER. When I went to the Federal Reserve Bank of New York, there was a sick looking plant stuck in the hallway outside of my office. I said to my secretary, "Get rid of that plant." [Laughter] A week later, it was still there. So I said, "Why is that plant still there?" She said, "They had an officers' council meeting and decided that if they took it away, they would have to take away all the other plants, so they're still discussing what to do to replace them." [Laughter] That was the Federal Reserve Bank. [Laughter]

MR. KOHN. There's a story about Oliver Ireland sitting in his office on the first floor of the Board building in the Legal Division. He looks out the window one day, and there is Paul Volcker pulling weeds or ordering people to pull weeds out of the garden.

MR. VOLCKER. I don't remember that, but I remember being bothered by something outside.

MR. KOHN. You said that when William Miller became Chairman, you began to dissent.

MR. VOLCKER. That's probably right.

MR. KOHN. Did you see the economic situation becoming increasingly dire?

MR. VOLCKER. Miller had this peculiar thing. I guess it was a discount rate decision where he was outvoted, and his response to the question seemed to be, “What’s the big deal?” He obviously didn’t care about the loss of perceived authority.

At one point, W. Michael Blumenthal and Charlie Schultze—and I don’t remember who was in the Office of the Management and Budget, but at least those two—came over to the Fed. I thought it was to make a presentation to the Federal Open Market Committee in favor of tighter money. It may have been a much more informal thing, but it was either at an actual meeting or it was called together informally. It was when the dollar had gotten very weak, and the Administration backed a strategy that was invented largely by [Anthony M.] “Tony” Solomon, I think, where they sold “Carter bonds” and involved raising the discount rate. We’re talking about November 1978.

Miller went along with it, but he was not the protagonist. They had to have some Reserve Bank ask for a discount rate increase. They had a special meeting to raise the discount rate. So I got involved in the discount rate decision. We had to operate in the market, too. It was the Treasury that pushed that package. I was kind of a partner in crime, but they were the principal pushers.

MS. FOX. You were at [the] New York Fed, and things aren’t working well in Washington. Who were you talking to at Treasury, and was there strategizing going on in which you were involved?

MR. VOLCKER. There was a connection with Tony Solomon, who had my old job. John Heimann was Comptroller of the Currency. I made two bad executive decisions. To his lasting credit, Burns was worried about all the lending to Latin American countries, and he made some rather strong speeches. I was making a big speech one day at the Waldorf, and Burns was

making a speech in another room on that subject. His speech was much more important than my speech, I'm sure.

The first bad executive decision was that Burns and I cooked up this thing—it was from the idea that we had to be stronger as a supervisor of banks that were lending a lot to Latin America. A matrix was developed in New York for application throughout the System. Depending on how exposed a bank already was, how much it was lending and to which country it was lending, and depending upon the weakness of the country to which it was lending, the bank was going to get a green light, a yellow light, or a red light. As near as I could tell, we introduced this system, and no commercial bank paid any attention to it whatsoever. They went barreling on lending. If you're going to be a supervisor/administrator, people understand "yes" and they understand "no," but they don't understand anything in between.

Burns was right to be concerned about the lending. Nobody else wanted to do anything about it. I didn't do much either when I became Chairman, which was my second bad executive decision. There wasn't much you could do. We sat there. We knew Mexico was going bad; the U.S. Treasury didn't want to listen to that. That was nothing unusual. Some Mexican Treasury officials became concerned about how much Mexico was borrowing. They told then-President José López Portillo that Mexico had to stop and had to tighten up a bit and not borrow so much money. According to one story, he sent his son around to quiz American banks about whether Mexico was in trouble, and his son, after his visit, said, "Borrow all you want. There's no trouble whatsoever."

That was in the summer of 1981. Mexico was shut off rather abruptly in January or February 1982. Once one or a few banks stopped lending, everybody stopped lending, but the Mexican authorities couldn't do anything, because Portillo wouldn't do anything. Mexico lost

reserves, and they were lent some money for a day or two through the swap lines and didn't tell anybody at the time. The Mexican central bank, at that time, only published their reserves twice a year. They published their reserves in May or something, so we lent them some money to window-dress their statement.

MR. KOHN. And somehow it was buried in our statement?

MR. VOLCKER. I don't remember what happened to the Fed's statement. That's a good question. I guess it wasn't big enough to show. But then I guess we really lent them some money a month or two later. The idea was to lend enough money to last until September. Portillo was effectively out in September; at least the Mexican position was that he would be out. He wasn't legally out, but that was his swan song in September. So we lent enough money to last until September. And, unfortunately, they ran out in July. [Laughter]

Chairman of the Federal Reserve Board: August 1979–August 1987

MR. KOHN. You became Chairman on August 6, 1979. Did you start this train rolling toward tighter monetary policy right away?

MR. VOLCKER. There may have been a discount rate change just before I became Chairman. Was it just before or just after?

MR. KOHN. There was one on July 20, 1979, that was a half a point increase; another half a point in the middle of August; another half a point in the middle of September.³⁶

MR. VOLCKER. I think when I became Chairman, there had just been a good-sized increase in the discount rate.

MR. KOHN. Right. That would have been the half a point.

³⁶ Historical data (starting in 1971) on the discount rate are available at Federal Reserve Bank of New York (2008).

MR. VOLCKER. And then one as soon as I got in there. Then I guess I made another. I had forgotten about that. That's the one where there must have been a 4–3 vote.

MR. SMALL. September 18, 1979.

MR. VOLCKER. That was the 4–3 vote. I thought we were going pretty well. We had three discount rate increases in a month or so. And I thought this is supposed to impress the market. Instead the market said, "This is the last we will see out of these guys." [J.] Charles Partee, Nancy H. Teeters, and Emmett J. Rice were against the September rate increase. But their dissents didn't bother me particularly, because I knew I had four votes, and if I had wanted to raise rates again, I'm sure it would be the same. Wallich was going to vote favorably. Frederick H. "Fred" Schultz was going to do whatever I suggested, and Phil Coldwell was in.³⁷ It was clear to me that there were four votes. The market said, "Okay, 4–3 vote, very unusual. That's the end of it." So I thought, "We've run out of steam on this particular approach. Let's think of something that's really going to impress the market." That's when we started thinking about new operating procedures. I didn't know it was as late as September 18.

MS. FOX. Well, it's still pretty quick. You had just become Chairman.

MR. VOLCKER. I may have thought about it before September 18, but that would have been the time I told Axilrod and you and whoever was around to begin thinking about this.

MR. KOHN. I actually wasn't involved, myself.

MR. VOLCKER. Steve Axilrod has written a book. He describes the memorandum that he and Peter D. Sternlight cooked up, describing how the new procedure would work.³⁸

MR. KOHN. FOMC members came to town on that Saturday.

³⁷ Phillip E. Coldwell was a Governor of the Federal Reserve Board from October 1974 to February 1980.

³⁸ Stephen H. Axilrod was Staff Director in the Office of Staff Director for Monetary and Financial Policy. For more on the memorandum, see Axilrod (2009, pp. 97–99).

MR. VOLCKER. I don't know if we were meeting on that Friday before by telephone or not, but that's when I guess I handed out that memorandum.³⁹ I said to go think about this memorandum, because that's what's going to come up at the Saturday meeting.

MR. SMALL. You handed it out to the Board members only?

MR. VOLCKER. It was only to the Board members?

MR. SMALL. The president of the St. Louis Fed at the time said that he was called to the Board for the Saturday meeting and arrived not knowing what was up.

MR. VOLCKER. No, he might have been there by Friday. There was a meeting late on Friday. I had forgotten about it entirely, but I saw a transcript of it [laughter], so I guess the meeting existed. It was a short meeting. I said, "We're going to have this meeting tomorrow. It's going to be a big decision. That's why I got you here on a Saturday. We have this little memorandum. Read it, and you can't give it to anybody else." And the St. Louis guy, maybe it was him on the telephone, said, "Can I at least show it to my research director?" I guess I said you can show it to one person. [Laughter] That was a very short meeting. That was the first they knew anything about the new operating procedures, I guess.

MR. SMALL. But at the meeting you presented an option, right? The FOMC could go with what they had been doing, or they could go with this new procedure?

MR. VOLCKER. At the meeting itself, yes.

MR. KOHN. But before you got into the FOMC meeting, you had a pretty good idea it was going to be approved?

³⁹ For a transcript of the October 5, 1979, meeting and the related memorandum from Messrs. Axilrod and Sternlight on the subject of Proposal for Reserve Aggregates as Guide to Open Market Operations, see, respectively, Board of Governors of the Federal Reserve System (2010) and Axilrod and Sternlight (2010).

MR. VOLCKER. Part of the attraction of the whole approach to me was that some of the Reserve Bank presidents had been urging something of this sort—not particularly then, but years earlier. Frank Morris had this bee in his bonnet about it. But there were one or two others. And there was some committee—

MR. KOHN. The Committee on the Directive that Frank ran or was on.

MR. VOLCKER. —some committee actually looked at this some years earlier, and the recommendation of putting more weight on the monetary aggregates got rejected. So I knew that there would be some sympathy for the new operating procedures from St. Louis and Boston. New York didn't have a president, but I would have broken the alternate Committee member's arm if he didn't go along with me. [Laughter] I was uncertain about a couple of them, but I did think, "This is the one time that we better darn sure be unanimous."

MR. SMALL. There's a story about the Belgrade conference, and that you flew to that conference with Charles Schultze and Miller and talked to German officials. How much did you tip your hand?

MR. VOLCKER. On the flight over, I told Miller and Schultze what I was thinking of doing. Of course [laughter] it was news to them: "Well, let us think about it, don't be too hasty." By happenstance, we stopped at Hamburg. I don't know why—because Schmidt or someone asked us to. I think he was the chancellor of West Germany at that time. We met up with Schmidt. He had a nonstop harangue about how the United States had no courage and no willingness to do what was necessary. He said it was time the United States stood up: "Don't you understand the world's falling apart?" He went on and on and on. I don't think Schultze or Miller got a word in edgewise. You would have thought that I put Schmidt up to all this.

[Laughter] But I think it made an impression on Schultze and Miller—they got this barrage just after hearing about this new proposal of mine. So I didn't hear much from them. [Laughter]

MR. SMALL. Did Schultze or Miller ever ask you how high interest rates would go under these new procedures?

MR. VOLCKER. If they did, the answer would have been "I don't know," because I didn't know. I sure never thought they would go as high as they did.

MR. KOHN. Did you have any more back-and-forth with the Administration after that plane trip?

MR. VOLCKER. Well, not much. Schultze and Miller went running back and talked to President Carter. By that time, I was pretty well convinced of the need to go forward with the new procedures. The President was in kind of a box, because he had just appointed me.

[Laughter] He didn't know about the new procedures. They said to me, "We've talked with the President about it. We don't like it. We think it's very risky. We'll support you fully if you just raise the discount rate another 1 percent or something, but don't do anything else." That was their opinion, but I did not take it as their presenting a stone wall against my moving ahead with the new procedures. I think in a separate conversation with Tony Solomon, he was urging me to do it. When he heard my position, he was all in favor of it.

MR. KOHN. Lyle Gramley was at the Council of Economic Advisers then.

MR. VOLCKER. I think Lyle took the view that the Fed didn't really have to do the new procedure I was advocating. His thought was, "I understand that you have to do something, but it is too uncertain." But they weren't laying down any laws.

MS. FOX. Around here, Stephen H. Axilrod and Sternlight knew, but was there anybody else? Were there internal debates about it by the Board staff?

MR. VOLCKER. David E. "Dave" Lindsey knew about it.

MR. KOHN. Ed Ettin knew about it. He was working for Steve at the time.

MR. VOLCKER. Ed [was] very proud of his analytical forethought. He would remind me that he had given me a memorandum telling me how big the savings and loan losses were going to be.

MS. FOX. And he got it right?

MR. VOLCKER. Well, I had been up to \$50 billion in my mind. And I think he was higher than that. [Laughter] I think it ended at \$150 billion. Just like the other crises.

MR. KOHN. \$150 billion sounds low to me right now.

MR. VOLCKER. Whatever the estimate is the first time, multiply it by 4. That's where it ends up.

MR. KOHN. How did the transition from the New York Fed to the chairmanship of the Board of Governors come about? Do you know what the Carter Administration was thinking? Who talked to you about taking over?

MR. VOLCKER. I have heard slightly different stories. David Rockefeller certainly thinks he was offered the job of Chairman of the Fed. He's a very nice guy, but he wasn't built to be Chairman of the Federal Reserve. I don't know if I heard another name.

MR. KOHN. The Administration decided they needed to get Miller out of there?

MR. VOLCKER. No, I think it was the opposite. President Carter was in big trouble. He went to Camp David and consulted with everybody in the world. He didn't consult with me. He was getting advice and writing things down. He decided he had to do something, so he got rid of a couple of cabinet officers, including [W. Michael] Blumenthal. Maybe Blumenthal was pressuring him to support tighter monetary policy, I don't know. Anyhow, Carter didn't get

along well with Blumenthal, so Blumenthal was out. Then he had to get a Secretary of Treasury. I guess he got along well with Miller and thought he was promoting Miller, mistakenly thinking that Secretary of the Treasury was more important than the Chairman of the Federal Reserve.

And this is my story: Carter was left with a vacancy in the Federal Reserve, which he hadn't thought about. Then he suddenly realized, and people told him, "You can't leave the Federal Reserve chairmanship vacant. You're in the middle of a crisis. You've got to do something." This all happened in the matter of two to three days. Somehow my name came up, which I guess was not illogical. Tony Solomon says he pushed it, and maybe some other people did, but Tony Solomon certainly says he did.

I got a call from Miller one day, and he said the President wanted to see me. So I came to Washington, and we had a conversation. I said, "You're thinking of making me Chairman of the Federal Reserve? You've got to understand that I'm going to have a tighter policy than Mr. Miller, and I feel very strongly about the independence of the Federal Reserve." I went home and had dinner in a restaurant with a couple of old friends of mine, and I said, "Well, I'm not going to be Chairman of the Federal Reserve." [Laughter] I forget whether it was the next day or two days later, but the phone rang, and I was still in bed. I didn't want to admit to that: "How are you Mr. President? I'm still in bed!" [Laughter] He said he would appoint me Chairman of the Federal Reserve, and that was it.

MR. KOHN. And he knew what he was getting into.

MR. VOLCKER. I didn't want to be in a position of not having told him I was going to be tighter. Miller was sitting right there. Miller didn't say anything.

MS. FOX. One of the stories I read was that Bert Lance argued against you, and Stu Eizenstat said you were Wall Street's candidate, and that kind of carried the day.

MR. VOLCKER. My memory of Stu Eizenstat had nothing to do with me directly. Carter's budget in January for fiscal 1981 was poorly received. So he decided to start over again on the budget. That's when he got this thing in his head about credit controls. At that point, he thought he needed me for credibility, so he asked me if I would join the Administration people in talking to the key congressional people about a need for budget restraint, which I did. I was just sitting there, not really doing anything.

Then Carter had the final meeting where he was going to decide upon precisely what to do. I was just a spectator. Eizenstat went over all the budget reductions that had been proposed. And when someone would say, "We'll cut"—I don't know—"the amount for the Army Corps of Engineers projects"—and so on and so on—"cross that out." Carter would say, "Okay." And Eizenstat would say, "There's a lot of opposition to that. That's a big, politically sensitive area, and there's a lot of Democratic support for not doing that. I wouldn't do that, Mr. President. You better rethink that one." I'm making these up, but there are three or four of these, and Carter's initial reaction was, "Okay." And Eizenstat would come back and say, "You know that dam in Idaho—" or whatever. Carter would say, "We'll do half of it." [Laughter] That's the way all the decisions were made. And, it seems to me, that's what killed Carter. He was caught between his own conservative instincts and the party that was way to his left on this stuff. He ended up compromising, and it came out as mush.

MR. SMALL. Carter did a lot to decontrol domestic oil prices.

MR. VOLCKER. That was before my day.

MR. SMALL. There's a story that was part of a foreign exchange negotiation.

MR. VOLCKER. This was considered by those participating, like Fred Bergsten, as the high point of international economic cooperation.⁴⁰ They had a summit meeting, when those meetings were still considered potentially important, and a deal was made that the Germans would ease their monetary policy and Carter would ease oil controls and let the oil price go up. There may have been other things in the agreement. Schmidt had always been furious about the deal for easing German monetary policy. Biggest mistake he ever made, conceding to ease money at just the wrong time for Germany.

MR. SMALL. We were talking about October 1979. One attractive element of the new operating procedures was the discipline of money targeting, and that people pretty clearly saw a link between money and inflation. But then, within a year, you get into distinguishing M1A from M1B, and this and that, and you get into credit controls. All of a sudden, this really clear, simple, and straightforward approach becomes not so simple and clear. How did that feel?

MR. VOLCKER. In the end, I think it worked out okay. It was a mess, that's for sure.

MR. SMALL. You became a technician about defining M's [money-stock measures].

MR. VOLCKER. Boy, we had more M's. The figures now don't show it because they've all been revised, but by early 1982, we were in a pretty bad recession. You began looking around and hoping for some relief. I think the record will show that if you look at the Greenbook or whatever: "The Board staff said recovery would begin in the spring." That seemed pretty good. We were psychologically ready to do a little easing, but the money supply kept coming in very high. We couldn't be easing while the money supply was coming in high. And the money supply never went down. And the great spring recovery never happened either.

⁴⁰ See the discussion of the Bonn summit on July 16–17, 1978, in Volcker and Gyohten (1992, pp. 350–51).

[Laughter] So we were really getting caught hoisted by our own petards because the money supply was high and the economy stunk.

My memory is that sometime in July, the money supply finally came down for a couple of weeks, and we said, “Ha, ha, we can ease.” We took some little step, and the market took off, and the crisis was kind of over. But you can argue that we should have eased six months earlier. In my own head, it was a self-justification. I think it’s just as well, as we did do what we did by mistake, because we had to drive the lesson home. [Laughter] The inflation rate still wasn’t coming down, and we had another six months of bad recession, but in my mind, it could have been worse.

MR. KOHN. I was going to [Federal] Open Market Committee meetings by then. My memory of that period was that we did have this easing in July or August, and then the money supply ticked up again in September, and you sat there and said, “I am not going to tighten monetary policy.” And that’s when using the explanation, shall we say, of deregulation distorting the monetary aggregates—you gave a speech.

MR. VOLCKER. I had to go to the Business Council meeting. I had a great figure of speech, “We’re living in the same house, and we’re just moving from one room to the other.” That wasn’t quite it, but it was something like that.⁴¹ Did I say in the Open Market meeting that we weren’t going to tighten? Because some of them were real hawks.

MR. KOHN. They were true believers in the monetarist kind of thing.

⁴¹ “Let me repeat, once more, the emphasis on M1—what shall I say. The wind blew a tree into the house so we had to move to an apartment while we repair the house. It had nothing to do, it’s got no policy content whatsoever. It is a recognition of the reality that the M1 figure will be distorted and nobody will be able to make an intelligent judgment for some time about what an M1 figure means. Zero policy significance” (Volcker, 1982a, p. 6).

MR. VOLCKER. If you look at the money supply figures, you've got to go back to the ones that were originally published.

MR. KOHN. Yes, we got some from the Bluebook back then.⁴² [Kohn and Volcker look at chart 3, "Actual and Targeted M1," from the Bluebook of December 17, 1982.]

MR. VOLCKER. Those are the original ones?

MR. KOHN. Yes. So the money supply must have been coming back just barely within the target range when you cut interest rates. [Laughter]

MR. VOLCKER. You're exactly right. [Laughter]

MR. KOHN. Then money growth took off again.

MR. VOLCKER. See, here is what happened in December, there you are. The [M1] money supply jumped way up in December [of 1981] and went way above our target right at the beginning of the new year. [Laughter]

MR. KOHN. So it must have ticked up a little, and then the borrowing objective was saying we needed to tighten, and I remember you sitting there saying, "That's not going to happen."

MR. VOLCKER. I didn't realize it was that bad. [Laughter]

MR. KOHN. Well, part of that was truly decontrol. The All Savers Certificates had been put in a year before, and that program was expiring.

MR. VOLCKER. I guess that was part of our excuse.

MR. KOHN. Right.

MR. VOLCKER. That was a legitimate excuse.

⁴² The Bluebook was part of the materials prepared for the Federal Open Market Committee by the staff of the Board of Governors of the Federal Reserve System. See the December 17, 1982, Bluebook, chart 3, "Actual and Targeted M1."

MR. KOHN. Yes, that part.

MR. VOLCKER. Yes, that's right. It was.

MR. SMALL. Here is the January 1982 Greenbook forecast you were talking about showing strength.⁴³

MR. VOLCKER. Yes, they had a recovery in the second quarter. They had a real boom by the third quarter.

⁴³ The Greenbook materials were prepared by the staff of the Board of Governors of the Federal Reserve System for the Federal Open Market Committee. See the January 27, 1982, Greenbook, p. I-7, "Staff GNP Projections."

July 22, 2008 (Third Day of Interview)

This interview took place on July 22, 2008, at the Board of Governors. Lynn Fox and David Small of the Board staff continued their interviews of Paul Volcker, former Chairman of the Board of Governors of the Federal Reserve System.

The New Operating Procedures: October 6, 1979

MS. FOX. Former Federal Reserve Board Governor Lyle E. Gramley was a member of the Council of Economic Advisers from 1977 to 1980. According to Lyle, he was asked by the Administration to visit you and tell you not to cause trouble by adopting the new operating procedures, which he did in a gentle way.⁴⁴

MR. VOLCKER. Yes. I think that's fair. The Administration said they'd prefer us not to go ahead with the new procedures, with various degrees of emphasis, but they never made it a directive.

MR. SMALL. Earlier in the interviews, you had said that the Administration conveyed to you the message: We can understand if you raise interest rates a full point or even two, but this new procedure you have in mind is very risky.

MR. VOLCKER. The old way was safer. Why take the chance on this other stuff? Yes, I didn't remember it was Lyle, but I think other people felt that way as well. Anthony M. "Tony" Solomon also said, "If you really think it's important, go ahead and adopt the new approach."

⁴⁴ On October 6, 1979, the Federal Reserve adopted new monetary policy procedures that led to skyrocketing interest rates and recession but also broke the back of inflation and ushered in a period of low inflation and general economic stability in the United States.

MR. SMALL. One common story is that the new policy procedures were just a way for the Board to wash its hands of interest rates and to say to the Congress and the public, “We are not raising rates. It’s the markets.” A slightly different story is that the new procedures were a way to have interest rates increase first through this automatic mechanism and then have the Board face the higher interest rate as an accomplished fact. In other words, the market would raise rates, and the FOMC wouldn’t have the difficult task of directly debating and voting on whether or not to raise interest rates.

MR. VOLCKER. This Machiavellian kind of interpretation irritated me. It was not so common at the time—in the fall of 1979—but became a cynical comment later even in the Federal Reserve itself, and I didn’t like it. The transcript of the October meeting indicates that we knew a rise in short-term interest rates was needed, so we were ready to raise rates anyway.

I keep coming back to the NY Fed speeches, in which I gave a rationale for spending more time on the monetary aggregates.⁴⁵ It reached the point where we wanted to discipline ourselves. It was easier to nail our flag to the mast of the monetary aggregates than to continually fiddle around directly with interest rates, where you always had the danger of being too late. From the transcript, it’s clear why people were hesitant about raising interest rates directly. We needed some other tool to discipline ourselves. It was also a better message to the public. The connection between interest rates and inflation is always very foggy. People said, “If interest rates are going up, that’s inflationary. What are you doing?” But people understood—partly because of Milton Friedman and his constant harping on it—that too much money is inflationary. So we took advantage of that in conducting policy and trying to help educate the public on what the real object was, which is a little different from saying “We know

⁴⁵ See Volcker (1976, 1977).

what interest rates should be, and this is a roundabout way of getting to them.” We didn’t know what interest rates should be. I was always a little disappointed in my naiveté that when, in our oratory and policy, we got tighter, long-term rates should have come down. That would have been a sign of great victory. But long-term rates kept going up, which didn’t indicate that we were as credible as I would like to think we were.

MR. SMALL. Did you think through an all-out effort of public education with Governors going out and talking to key constituencies and educating them about the new procedures?

MR. VOLCKER. We didn’t do it in that kind of organized way. We should have. But you never knew what the Governors were going to say anyway. In a broad sense, yes. Every word I uttered was an attempt to educate the public or some member of the Congress. You are always very conscious of that.

MS. FOX. At the October meeting, you didn’t just announce that policy would focus on the monetary aggregates, you announced a whole series of alternative measures of the money supply. You were trying to find anything you could to throw into that public announcement that would get people focused.

MR. VOLCKER. No doubt about it. We thought this business about the aggregates was the most important, but that wouldn’t be understood so easily. They understood increases in the discount rate, increases in reserve requirements. We put in everything we could think of.

MS. FOX. And were you thinking about Wall Street, the bankers, or the general public?

MR. VOLCKER. All of them. We just wanted to make an impact. We wanted to make it look like we were determined.

MS. FOX. Why do you think that credibility was so hard to win at that point?

MR. VOLCKER. Because you had gone through a decade of rising inflation and a chorus of criticism. It was a constant feeling that we were behind the curve in dealing with inflation. So when we did things that ordinarily would have been thought fairly strong actions—like three increases in the discount rate in a month and a half or whatever it was—then the end of the story was, “Oh, they are still behind. We’ll never catch up.”

Relationship between Chairmen and Vice Chairmen

MR. SMALL. How did you work with Frederick H. “Fred” Schultz, who was the Fed’s Vice Chairman from July 1979 to February 1982? What role did he play? What lessons are there about Chairman–Vice Chairman relationships?

MR. VOLCKER. We had a good relationship. But Fred Schultz was an odd person to be appointed to the Federal Reserve. People asked, “What’s this Florida politician doing on the Federal Reserve Board?” He had a different way of approaching things, so there was a question: Given the suddenness of Chairman Miller’s departure in August 1979—leaving the Fed without a Chairman—maybe President Carter would nominate Schultz to be Chairman. You didn’t know at the time whether Schultz was really ambitious to become Chairman or not. What he said at the time, which was a perfectly appropriate thing, was, “If you’re going to make me Chairman, I’m ready to serve, but I’m not running for the job.” I met Schultz before he joined the Board. He came to New York to meet me when he was nominated. I don’t know why it took him so long to get confirmed.

MS. FOX. Senator Proxmire didn't want to confirm him but mainly didn't want him as Vice Chairman.⁴⁶ President Carter had nominated him to be a Governor and then added on the Vice Chairmanship.

MR. VOLCKER. Oh, was that it? Proxmire thought he wasn't qualified to be Vice Chair?

MS. FOX. Yes. And I think Proxmire ultimately voted for him to fill the Governor vacancy but against him as a Vice Chairman.

MR. VOLCKER. Okay. Schultz wanted to be helpful. He thought the role of the Vice Chairman was to help the Chairman, which was a comfortable feeling for the Chairman, obviously. He took a lot of the—not exactly scut work, but a lot of the bureaucratic work. And you could rely on him. For a while, he was the Governor in charge of the staff here, and they got to like him. He was good with the Reserve Bank presidents and with the chairs of the Banks' board of directors. He had a certain self-confidence about him. He had a good sense of humor. He was great. I had every confidence that he was ready to support as tight a policy as I was willing to support. So there was never any discomfort with him.

MR. SMALL. Are there political science lessons or appointee lessons to be learned here?

MR. VOLCKER. Well, the Federal Reserve Board is kind of a *sui generis*, so I don't know if it's odd. The tradition at the Board has been pretty collegial. When I came here, there was a sense of substantial, obviously not perfect, deference to the Chairman on administrative matters. That hadn't always been true. Obviously, I wasn't directly involved, but, going back to the middle of Chairman Martin's term, there was a big question in Martin's mind about whether he had enough authority over administrative matters. I guess he was annoyed by the

⁴⁶ William Proxmire was a Democratic Senator from Wisconsin and served as Chairman of the Senate Committee on Banking, Finance, and Urban Affairs from 1975 to 1981 and from 1987 to 1989.

Board attempting to micromanage the staff and so forth. I don't think he ever got that resolved. I think it was resolved de facto, as I remember. I don't think there was any official Board decision on the division of responsibilities. During Martin's term, J.L. Robertson was Vice Chairman [from 1966 to 1973]. He was a strong-minded guy who had been Comptroller of the Currency, so he was important in banking supervision and had very strong views. I'm not sure how well he got along with Martin, but he had a particular role because of his particular experience.

George W. Mitchell was the Vice Chairman [from 1973 to 1976] when Arthur F. Burns was Chairman. Stephen S. Gardiner, from Philadelphia, was Vice Chair [from 1976 to 1978]. Gardiner wasn't a politician, but he was more in the Schultz mold. He thought it was important that he support the Chairman, and he probably did the administrative stuff on the Board. He was an effective Vice Chairman, I'm sure, in the Chairman's view and in my view.

Working with Other Governors, Reserve Bank Presidents, and Board Staff

MR. SMALL. To what extent does a Chairman have power and influence over Board members through committee appointments and over Reserve Bank presidents through the budget process?

MR. VOLCKER. At least by my day, you had considerable authority, and nobody really objected. You could assign—and assign is maybe too strong a word—particular Board members for particular responsibilities. Some of them liked those assignments, and some of them didn't. But it was not a tremendous issue, because some of it was really natural. It was not a big problem.

But the Board is so unlike some other agencies. The contrast I saw was with the SEC [Securities and Exchange Commission], which is a strong, independent agency. Those SEC

members don't talk to each other. I don't know if it's changed now, but they each had their own staff. They had their own lawyer and their own economist. It was a very formal process: Somebody came before the Commission, the papers would have gone to the commissioners' personal staffs, each commissioner would talk to his own people, and he would come into the meeting with a position that he'd state. I guess the meetings were in public. I don't know. But that's an entirely different atmosphere than what existed here at the Board. Each Board member did not have his own staff. Sometimes, informally, it was understood that a particular staff guy would work with a particular governor so long as those people understood that if the Chairman wanted them for some reason, that would take priority.

MS. FOX. When I came here, it was very much part of the culture that the Governors did not have special assistants or key staff. Was that something that was already established by the time you came?

MR. VOLCKER. Yes. I think that's been a tradition of the Board in general terms. That's as much as I'd know about it.

MS. FOX. At times, some Board members have expressed concerns about senior staff members having too much clout. Was that ever an issue in your era?

MR. VOLCKER. That was probably truer with Chairman Burns. Steve Axilrod is coming out with a book that deals with that kind of question. This is all filtered through the perspective of his central role, and I think he probably refers to that kind of problem. Axilrod was very important.

Having come from the New York Fed, I knew quite a lot about the Federal Reserve. I had come to rely heavily on E. Gerald "Jerry" Corrigan up there and felt very comfortable with him. He came to Washington for a few weeks during my transition here. Jerry's stay here

turned out to be a year or more. The Board staff didn't like it so much, that they felt that they had to report through Corrigan, which wasn't quite true. I think they got used to it. Off and on, Burns had had an assistant in that role.

MR. SMALL. Were there any issues of, say, Governors finding certain staff economists to generate results that would pit staff against staff and be aligned against other Governors?

MR. VOLCKER. There was a certain amount of tension under the surface, but everybody was pretty sensitive to it. Based on Board tradition, it was unfair or unreasonable to develop a position with the help of the staff that would have been a different policy. But, of course, if a Governor had some position different from the Board's or FOMC's and he wanted some evidence for it, he could call upon a staff member to help. But I think the staff was very chary about being put in the position of becoming aligned with a particular Governor, especially on views that differed from those of the Board or FOMC.

The Governor that had the most staff assistance—because he wrote so many speeches and had strong international responsibilities—was Henry C. Wallich. But that was not getting into policy differences. That was to help him on his endless number of speeches and other responsibilities.

MR. SMALL. At times, the idea has been floated in the public that for different policy issues—for example, health care, energy, global warming, or whatever—the Board model should be followed. Do you think the Board/Fed model is robust and transferable?

MR. VOLCKER. I think it's probably a product of a culture that developed over many years. It's just as likely that you could set up a board that would be on the SEC model. But, by law, the SEC board has got to be partly Democrats and partly Republicans, which creates a different atmosphere. Everybody has their own ideas about this.

This is a very self-serving position, but I think you should have a board; I'm talking about monetary policy. You shouldn't have just one guy, as some central banks do. You should have a board. The board is there as a safety valve to prevent the chairman from doing something beyond what could be broadly supported. Ordinarily, the board should play a secondary role. The board chairman is always the one that's out in public. You've got to have one voice to be coherent, but it's important to have a board there so that he doesn't get too far ahead.

MS. FOX. Can you think of times when the Board or Board members saved you from going too fast or going in the wrong direction?

MR. VOLCKER. Well, it was the opposite when we changed the policy procedures in 1979. From the transcript of our October meeting, I was the one who said, "We don't know what's going to happen to interest rates after all this. There could be big changes, and we're ready for a big change. But before it gets too big, I want to take another look at it." During that meeting and in subsequent meetings, there was a considerable opinion developing in the Board—maybe more in the Reserve Banks than the Board—to not constrain this at all. I was always leery of that. In fact, I always insisted that we have nominal limits—I think we called them "consultation limits." Every time we met one of those limits, we overrode it at the end, but I still wanted the consultation.

MS. FOX. But you would have a conversation about it.

MR. VOLCKER. Yes. At least one of us would have the conversation.

MS. FOX. One of the stories about you is that you weren't always fast in making up your mind, and that Jerry Corrigan was helpful in pushing you into making up your mind.

MR. VOLCKER. That's absolutely true. I'm inclined to put off a decision as long as I can. This has been true since I was in high school and then college. I'd worry about an

examination the day before the examination and not two days before the examination. And right now, if I've got to write a speech, I put it off until it's absolutely essential to get it done.

MS. FOX. In looking at the transcripts of the discussions in the FOMC and from hearing from people, you were very collegial. It was very clear that you weren't that comfortable with monetary policy in the 1970s, but you did not create a big fuss until you actually arrived at the Board.

MR. VOLCKER. When I was in New York?

MS. FOX. When you were in New York.

MR. VOLCKER. Yes, well, that's just a question of how you play it. I was trying to get policy as tight as I could get it within the constraints of what Burns was willing to do. We always ended up, say, with interest rates of 3 percent. People would think it was appropriate to be $3\frac{1}{4}$ or $3\frac{1}{2}$, and I'd work hard to try to get it up to $3\frac{3}{8}$ or something. But I don't think that had anything to do with delaying decisionmaking.

I was the Vice Chairman of the FOMC, and I thought it was important that we not have too much overt disagreement, but I was getting pretty restless. I remember once or twice talking to a couple of the Reserve Bank presidents. They were making a big deal about this: "Why don't you be more aggressive and actually dissent?" I thought they ought to dissent, not me.

MS. FOX. Was it partly because of your relationship with Burns?

MR. VOLCKER. Well, my relationship with Burns was very odd. I was uncomfortable with his monetary policy when I was in the Treasury. I now understand it a little more after seeing transcripts from these White House recordings. I was dead set against Burns on this international stuff where he was, I thought, off the wall in terms of what he thought was possible.

He was an irritation as far as I was concerned, both before and after going off gold. But I did respect him as a business analyst. When I was in the Treasury, he lobbied me a lot.

There was one thing we did coincide on. It does not look very good, from my standpoint. He wanted some kind of a board to restrain prices and wages. He wanted some kind of manifestation of incomes policy. I thought we needed something, so we agreed on that. We had to do something extraordinary. I thought an incomes policy board would be ineffective, but I was a big believer in a temporary freeze in conjunction with going off gold. We had an inflationary threat that we needed to deal with. We would have this temporary—I was naïve—three-month freeze, and then we'd take it off. Well, we got the three-month freeze, but we followed it with controls for some time, and that didn't turn out very well.

In his paper, Abrams talked about the Nixon tapes.⁴⁷ Nixon never believed in the freeze. He didn't like it, but it was a political tactic to get him reelected, which is not the way I and others looked at it. Abrams states that that was the way Nixon looked at a freeze, and that's why we got it, which I'm sure there is some truth to. In retrospect, I was naïve to think a temporary freeze would work, but I was not alone. We used to talk about this with Burns all the time. He took the freeze as a second-best policy.

MR. SMALL. What was it like to argue policy privately with Burns versus with Miller?

MR. VOLCKER. I dissented a few times with Miller, but maybe not with Burns. Miller didn't have an economic background on the business cycle. I think Burns was a great student on the business cycle and the business outlook. You had to respect that. On the business forecast, Burns was wrong a lot, but, nonetheless, he had a pretty strong background in that area. Miller did not. Miller was a businessman; he made up his mind quickly, and he had an interest in the

⁴⁷ See Abrams and Butkiewicz (2007, pp. 6–9, 24).

administrative stuff and relations with the Reserve Banks. But Burns was difficult in that area. In these interviews, I have talked about the frictions between New York and Washington. Burns didn't like Al Hayes, which aggravated the historic friction.⁴⁸ Burns was very heavy handed, and the Board got very heavy handed on control of the Reserve Banks' budgets, salaries, and all this stuff, which was very irritating.

When I became president of the NY Fed, it took some of the pressure off, because Burns was rid of Hayes and we had a better *modus vivendi*, but it was still irritating. He'd push me and push me. When he was pressing me to take the presidency of the New York Federal Reserve Bank, he said, "We'll pay you \$100,000," which he thought was a great incentive. It was the highest salary that had ever been paid in the Federal Reserve.

There was another more important incentive that I knew about—if somebody came from outside the Federal Reserve to become a Bank president and he stayed for 10 years, they were promised a pension at age 65, I guess, that was no less than 40 percent of their salary. As I mentioned earlier, I negotiated it down to five years. That didn't look so bad when you are a poor man and you think that this isn't the greatest salary that I could make if I were back in New York in the private sector, but if I stayed there for a while, I'd at least get a pension of \$40,000 a year.

I no sooner got up there and Burns said, "I don't think we're going to pay you \$100,000 a year." He said, "It's too sensitive politically. I know we said that, but we can't do that." So I said, "Okay." You know, meek person that I am. But then, a month or two later, [Governor] Coldwell made a little visit to me, and he said, "You know, we've been thinking about this pension thing, of cutting the required time of service from 10 to 5 years, and we don't want to do

⁴⁸ Alfred Hayes was president of the Federal Reserve Bank of New York from August 1956 to August 1975.

it either.” [Laughter] At that point, I said, “If you take away that pension, I resign tomorrow.” So they backed off.

MR. SMALL. Was Miller’s starting point with the Board awkward because he inherited a Board that had been under the heavy hand of Chairman Burns? Whatever new Chairman came in, the Board members were determined to—

MR. VOLCKER. —to establish their independence. I think that’s right. But Miller was much more relaxed about this kind of stuff.

When I became president, the New York Federal Reserve Bank wanted to build a new structure across the street from the existing building. The plan had been pretty far advanced, and I had no emotional commitment to it at all. So I inherited this plan for the new building, which the Board and the Board staff didn’t like. The Board staff would get very obtrusive. The great issue [laughter], which we would not exactly joke about, was the size of the flagpole that was going to be on the new building. The Board staff said that we were building too big of a flagpole. [Laughter] But later—it would have been when Greenspan was Chairman—there was a big to-do about salaries, and not just the president of the Federal Reserve Bank of New York, but other salaries. Cy Vance was chairman of the board at New York, and to think of this distinguished Secretary of State and statesman coming down here and pleading the case to get the salary up by \$10,000 or something—he was furious about it, and I don’t think he succeeded.

MR. SMALL. After you left the Board in 1987, there have been two Chairmen: Greenspan and Bernanke. Upon taking office, did they have any questions for you about insights on running the Board?

MR. VOLCKER. To a limited extent. The only advice that Greenspan asked for, appropriately, was on some administrative matters—questions like, why did you promote or not

promote this guy, or why was this administrative change made? He had some questions about some other issues. It was not important stuff. It was purely administrative stuff.

MS. FOX. That would imply that there is no handing of wisdom from one Chairman to the next about managing this place. Everyone makes their own way.

MR. VOLCKER. I don't recall sitting down and saying, "Alan, this is the way you've got to handle the staff," or whatever. I'm sure it didn't happen. This is a very well-set place. People don't come in and make revolutions in the Federal Reserve.

This has nothing to do with my history, but with all that is going on now, there are questions about the extent of the Federal Reserve's authority and how deeply it should get into regulation. The Federal Reserve structure is not built for this business. If you do what Treasury Secretary Henry Paulson has called for or any big supervisory change, it's going to have repercussions on the whole structure of the Federal Reserve sooner or later.

MS. FOX. The structure of the Federal Reserve grew out of a 19th century, early 20th century construct. Did you feel that the structure was a real advantage, or were there parts of it that, if you had rewritten the Federal Reserve Act, you would have addressed?

MR. VOLCKER. Well, there are parts of it that are archaic. The way that Reserve Banks are organized, with technically private ownership and so forth, is a little bit of a problem, because most people didn't understand it. But if they didn't understand it, then they weren't going to ask—why do you have commercial banks electing members of the board of directors of the Reserve Banks, and those board members electing the Reserve Bank presidents, and all that stuff?⁴⁹ The regional roots of the Federal Reserve are important historically, and now maybe less

⁴⁹ "Under the Federal Reserve Act, each Reserve Bank has its own board of nine directors chosen from outside the Bank as provided by law. The boards of the Reserve Banks are intended to represent a cross section of banking, commercial, agricultural, industrial, and public interests within the Federal Reserve District. Three directors,

so. The actual function of the Reserve Banks is atrophying. What do you do? At some point, you probably have to face up to that.

There was a decisionmaking point fairly early under my term as Chairman. George Bush the elder was appointed head of a regulatory organization.

MS. FOX. That occurred when he was Vice President. It was called the Bush task force [the formal name is the Bush Task Group on Regulation of Financial Services].

MR. VOLCKER. They were going to reorganize banking regulation because they felt it was disorganized. You had a very aggressive head of the FDIC then, [William M.] “Bill” Isaac, who thought the FDIC ought to have more authority. And [Donald T.] “Don” Regan didn’t like the Federal Reserve anyway. There were problems with the Federal Home Loan Banks. Anyway, as I recall, it was a 13-man committee. Every regulatory agency had a member. I attended a beginning meeting. Vice President Bush chaired the meeting, saying, “We’re going to reorganize supervision, and we’ll send the staff out to work, and we’re going to propose it.”

There were staff meetings over time, which I never attended. Continuously, the Board staff would come to me and say that they all want to cut us up, and the votes are 12–1 against us on every issue, and you’ve got to do something. I didn’t see what I could do, so I didn’t do anything at the time.

designated Class A directors, represent commercial banks that are members of the Federal Reserve System. Three Class B and three Class C directors represent the public. The member commercial banks in each District elect the Class A and Class B directors. The Board of Governors appoints the Class C directors to their posts. From the Class C directors, the Board of Governors selects one person as chairman and another as deputy chairman. No Class B or Class C director may be an officer, director, or employee of a bank or a bank holding company. No Class C director may own stock in a bank or a bank holding company. The directors in turn nominate a president and first vice president of the Reserve Bank, whose selection is subject to approval by the Board of Governors” (Board of Governors of the Federal Reserve System, 2005, p. 10).

Since this interview and pursuant to the Dodd-Frank Act of 2010, the Federal Reserve Act specifies that only Class B and Class C directors select a Reserve Bank president and first vice president—still subject to approval by the Board of Governors.

Richard C. Breedon, who later became head of the SEC, was the junior staff person for the Vice President. The senior guy, the lawyer for the Vice President, Boyden Gray, was a much better-known guy.

A report was written that would have pretty well stripped the Federal Reserve of supervisory authority.⁵⁰ I called the Vice President's office and said that I wanted to come and talk to him before the next, and presumably final, meeting. I got a message back to come an hour before the meeting, which wasn't quite what I had planned. I appeared at the meeting, and, lo and behold, Don Regan was there. He had a similar problem. The staff proposed to take the Office of the Comptroller of the Currency out of the Treasury, among other things. He didn't like that, and he hadn't been following it month-to-month. He had told the Vice President that he wanted to see him.

I went to this meeting in the Vice President's office in the White House and said, in effect, "Mr. Vice President, this report is unacceptable to me as Chairman of the Federal Reserve." And Regan said, "Mr. Vice President, I have to tell you as Secretary of the Treasury that this report is unacceptable to me." So, the two principal officials involved were telling him

⁵⁰ The Task Group on Regulation of Financial Services (chaired by Vice President George H.W. Bush) was formed in 1982 and released its report in 1984. Speaking about financial regulation, Paul Volcker (1983) stated (pp. 14–15):

In considering the appropriate locus for regulatory oversight, it may be useful for me to make one fundamental point. The charter of any central bank, implicitly or explicitly, encompasses a responsibility for protecting and promoting the stability and orderly functioning of the banking and financial system; indeed, it was those concerns that led to the establishment of the Federal Reserve. The idea that something called monetary policy—defined as concern about some abstractions labelled monetary aggregates—can be separated from concerns about the strength and nature of the institutions that actually supply and manage the money supply strikes me on its face as illogical. . . .

But you should also understand that any so-called "reform" that had the effect of crippling the ability of the Federal Reserve to carry out its basic central banking responsibilities would be unacceptable to me. Those essential responsibilities encompass effective influence on, and an active presence in, those supervisory, regulatory, and operational areas critical to the stability of the banking and payments system. Lest there be any doubt in your minds, those concerns cannot, in my judgment, be met simply by receipt of information from other agencies.

just before the meeting started that the report was not successful. It was undoable. Breeden didn't know what to do. He had written the report. He was beside himself.

We had a discussion of what to do. It would be a critical decision for the Federal Reserve, in a sense. One logical possibility was to give the Federal Reserve authority over the biggest bank holding companies—forget about whether or not the bank subsidiaries were national banks—and the Fed might also have the small state-chartered member banks. The FDIC would not have been left with much of this pie. I said that if we do that, I'd prefer basically the status quo. It would have carved up the FDIC. In fact, I saved the FDIC. I think we could have cut out the FDIC entirely. I was so conscience stricken that I said, "No, we'll leave the FDIC in for the smallest banks."

And then we walked into the meeting. All of these people had seen this other report and thought we were all there to ratify it, but the Vice President said, "We have a few changes."

[Laughter]

The interesting thing is that this issue still exists. Here we are, 30 years later, and this is the question that is posed: Should the Federal Reserve be given authority over the big, systemically important institutions and let the rest of them go? At that point I didn't want to do that, because if we did that, individual Reserve Banks would have had nothing to do. We would lose our regional roots, and the next question would be to reorganize the Federal Reserve itself. I don't know if that was right or wrong, but that was the judgment I made at that time. If I had made a different judgment, we could have come out of that meeting with the Federal Reserve having full control over the 50 largest bank holding companies and their banks.

MS. FOX. You knew that changing the regulatory structure would, in some way, harm the Federal Reserve Banks. Did you believe that it was the role of the Fed Chairman to protect those operations?

MR. VOLCKER. Oh, probably. Yes, I didn't want to sell the Reserve Bank presidents down the river. But I think the main thing on my mind was, we would weaken the regional structure and the participation by these local businessmen and so forth, which is part of the strength of the Federal Reserve as an independent institution—a nonpolitical institution.

MS. FOX. How did those regional representatives, Reserve Bank board members, help or hinder your fight against inflation?

MR. VOLCKER. Well, they were generally more hawkish than the Board.

MS. FOX. So they stiffened the backs of the presidents?

MR. VOLCKER. By and large. I'm sure it wasn't uniform. The thorn in everyone's side for a couple of decades was the St. Louis Reserve Bank. It went off on its own tack very noisily. I guess some of that tradition still exists.

MS. FOX. But I think you said that helped you.

MR. VOLCKER. To some degree. When we made the transition to the new operating procedures, it was helpful because then they suddenly became supporters—suspicious supporters. But it's a tricky business. Sometimes it helps, and sometimes it doesn't. I don't remember precisely, but, by and large, the Reserve Bank presidents tended to be more on the tighter side than Board members, although it wasn't true of every individual, that's for sure.

Relationship between the Fed and the Congress

MS. FOX. How did you view the relationship between the Fed and the Congress before you came to the Board, and how did the relationship change during the process of the fight against inflation?

MR. VOLCKER. Well, certainly, I was always conscious of the fact that the Congress had a big role. The Fed is a creature of the Congress. The Congress could protect the Federal Reserve from Administration pressure. What saves the Federal Reserve in the long run is that the Congress doesn't want the Administration to have control of the Fed, and the Administration doesn't want the Congress to have control of the Fed. That is the unique aspect of the Federal Reserve, and it saves you.

But the Congress was pretty frustrated then and was ready to accept the change in monetary policy, which it wouldn't have been some years earlier, I'm sure. I can't remember any specifics, but Senator Proxmire was certainly sympathetic to an independent Federal Reserve, and he was certainly sympathetic to a change in monetary policy. I guess Henry Reuss was the chairman of the banking committee at that time.⁵¹ Reuss was an intellectual and very active in this area. He was not an opponent. We had very strong support from Bill Stanton, the top minority member.⁵²

MR. SMALL. How did you deal with the Congress during your chairmanship?

MR. VOLCKER. First of all, I didn't have much of a confirmation hearing. As best as I remember, I didn't go through all of the rigmarole of meeting individual committee members. There was a vacancy in the chairmanship, and they wanted to get it filled quickly.

⁵¹ Henry S. Reuss was a Democratic congressman from Wisconsin and Chairman of the Committee on Banking, Finance, and Urban Affairs from 1975 to 1981.

⁵² J. William Stanton was a Republican congressman from Ohio from 1965 to 1983.

As Chairman, I wanted to maintain control over who was talking to the Congress. There was no doubt about that. Fred Schultz had a political background, and I had complete confidence in him. He might have done more than a Fed Vice Chairman would have ordinarily done.

But shortly after I became Chairman, the Monetary Control Act [Depository Institutions Deregulation and Monetary Control Act of 1980] was under consideration in the Congress, and I wanted to get that enacted. So in the fall of 1979 or early in 1980, I spent a lot of time talking to the relevant chairmen and ranking members of the banking committees. During this period, it was fortunate for the Federal Reserve that the ranking member in the House committee, which was more difficult to deal with than the Senate for a variety of reasons, was Bill Stanton. He was an enormous admirer of Arthur Burns. I don't know whether he defended the Federal Reserve because he admired Burns or whether he became a fan of Arthur Burns because he was a defender of the Federal Reserve, but he was very sympathetic and helpful during all this period.

MS. FOX. Did you know many of those House members when you became Chairman?

MR. VOLCKER. From my Treasury days, I knew Henry Reuss, who had a mind of his own, and I knew Henry Gonzalez, who used to ask for my impeachment daily.⁵³ I knew some of the others from my Treasury days.

MS. FOX. Who taught you the art of dealing with the Congress?

MR. VOLCKER. I don't know if it was an art. I grew up in an atmosphere in the Treasury where we were pretty respectful of the Congress. There are some people who instinctively take the view that they are at war with the Congress: "Let's see if we can pull something over on them. Don't tell them more than we absolutely have to." That was not the

⁵³ Henry B. Gonzalez was a Democratic representative from Texas and later chaired the Committee on Banking, Finance, and Urban Affairs from 1989 to 1995.

atmosphere in the Treasury in the 1960s and certainly not in the 1970s when I was there. I was pretty open with those fellows. Not on monetary policy itself, but on other stuff.

MS. FOX. As a new Chairman thinking about the aggressive steps you were taking, did you devise a congressional strategy? Did you get help with one? Or did you just take it as it came?

MR. VOLCKER. I don't remember, particularly. Ken Guenther was at the Board then.⁵⁴ He probably had something to say about it.

MS. FOX. He said that he was ready to leave the Board when you became Chairman, but you talked him into staying. He stayed through the end of 1979, making his major contribution working on the Monetary Control Act legislation.

MR. VOLCKER. Yes, that's right. I don't remember how long he stayed, but I guess that's right. We had to get that bill through. I have some vague memories that my calendar would get filled up with visiting the Congress on this stuff, but nothing special about it. Proxmire was the chairman of the Senate Banking Committee. He was friendly with the Federal Reserve. The Chrysler bailout was in there someplace, either 1979 or early 1980. Proxmire—this isn't quite relevant to your question—he didn't like the legislation involving rescuing Chrysler, but it was going to pass. He was very insistent that the Federal Reserve be a member of the Chrysler loan guarantee board. He didn't trust any others, and I didn't want to become a member of the board. But he insisted. As it turned out, he was right, if I may say so.

MS. FOX. To keep the heat off and not give away the—

MR. VOLCKER. Yes, the idea of having a Federal Reserve guy on that board, I think, was important. But, you know, I had a good relationship with Proxmire. I must have known him

⁵⁴ Kenneth A. Guenther, Office of Board Members, Assistant to the Board (1975–79); chief executive of Independent Community Bankers of America (1982–2003).

a little. Stephen M. “Steve” Roberts, who was on his staff at that point, had been a Federal Reserve person. So there was some connection there. But I don’t know who else was on the Senate Committee at that point.

MS. FOX. Alan M. Cranston from California.

MR. VOLCKER. Cranston was there, and then Jake Garn later. I don’t know if he was on then. But Cranston was part of the savings and loan problem. He was not sympathetic to the Federal Reserve. He may have been the ranking Democratic member.

Reuss was very important, because he considered himself a scholar on monetary policy, international stuff, and so forth. He was pretty well known, and I knew Reuss reasonably well, because I once traveled through Sicily with him and went to a meeting—I think he was there when I was in the Treasury.

MS. FOX. A congressional trip?

MR. VOLCKER. It was some kind of a seminar—something we both went to. He wanted to travel around Sicily, and I wanted to travel around Sicily at the same time. I can remember banging around Sicily, and our car broke down. Henry Reuss was quite a character, pretending that he could speak Italian. Either that or, if he had a bad enough accent and spoke loudly enough, maybe they would understand him. But anyway, we all survived.

MS. FOX. How did you get out of that fix? Were you broken down on the side of the road with him?

MR. VOLCKER. The oil pan broke. [Laughter] We were at a hotel where a conference was being held in Taormina, which is a famous resort. Henry wanted to see Sicily. We had plans to fly to Palermo and drive back to Taormina. We went to the airport in the morning, but the plane didn’t take off because the pilot had overslept. So we decided to rent a car and make

the trip in reverse. We drove around Sicily. It's an interesting place to go if you haven't been there. Some of the roads were not very good. Henry was driving, and he was banging on this bad road. He hit a bump, and a rock pierced the oil pan of the car. The car stopped operating. We weren't all that far from Palermo.

MS. FOX. So you did know him very well. You'd seen him under stress.

MR. VOLCKER. Yes. He could be hard, because he had strong ideas about policy. But there was no personal antagonism, which was a help. In that way, I was fortunate. I had known him when I was in the Treasury. And I knew him from those two or three days that we were traveling together.

MR. SMALL. What was it like testifying before the Congress? Were there theatrics in the hearings?

MR. VOLCKER. When I used to see Alan Greenspan testifying before the Congress, I thought, "Thank goodness it's Alan Greenspan, and I don't have to sit through all of those things." I knew it was time to go when I had been at so many of those hearings my mind would drift during the hearing. You would be asked a question, and if you forgot which question you were being asked, it didn't make much difference. You'd go on. It's not a good idea to let your mind drift, but it was late in my term and whatever. You would hear the same questions all the time.

MS. FOX. A lot of times the hearings are about fiscal policy, and they want your views on the record to help or hurt a position.

MR. VOLCKER. Part of it is a game. You are trying to make your points. They are trying to make their points. That's natural. It's a kind of contest of which side can make their

point more effectively. You're sitting there thinking, "How can I answer this question consistently with the point I want to make?"

MS. FOX. Did many of them understand what was going on with changing the operating procedures?

MR. VOLCKER. I don't remember hearings about this. I think they were probably confused. I don't remember this being a big subject.

MS. FOX. You obviously had long-term relationships with big New York City banks. They had members of the Congress from New York who cared about the health of the banking industry in New York. Were they supportive?

MR. VOLCKER. I think they were reasonably supportive. I don't remember them being active politically. The only bank head that made much difference in those days was Walter Wriston. He was a dominant banking personality. I knew him because he was in New York and he was the head of the biggest bank, Citibank, and I was the head of the Federal Reserve. He had an ego. When Reagan became President, Wriston thought he was a key adviser to Reagan, which I guess he was, because he headed some economic policy committee they had. In the Citibank tradition, Walter Wriston was not a fan of the Federal Reserve. He was a fan of Citibank. He was pretty smart.

I had kind of a contest with him. In effect, it was a question of who was going to be the boss of the banking system and who would be the assistant. We were friendly, but there was clearly an implicit rivalry over who was going to be running the banking system. Walter thought that he ought to be running it, and I thought I ought to be running it, as the Chairman of the Federal Reserve. Then, of course, he got in trouble. When money got very tight, Citibank had a problem, as many banks did. He got in big trouble because he had lent so much money in Latin

America. And he made his famous comment that “countries don’t go bust,” and he was a great leader in foreign lending. When things didn’t go well, he said, “I didn’t know Volcker was going to put the blocks on the whole economy, and no one could expect that,” and so forth. In some sense, we later had to be allies then, because I had to control the Latin American debt situation, and he had a big stake in it. So he had to cooperate with me in dealing with the situation.

It was in Citibank’s DNA—it goes way back—that they would fight authorities every step of the way. Back when I was a young guy at Chase Manhattan, I was pretty close to Chase Manhattan’s main outside lawyer. He was a well-respected guy and very conservative in his legal and policy advice. Citibank had a very aggressive lawyer. He was from Sherman and Sterling, the main Citibank law firm. His view and the bank’s view were: Whatever rule there is, see how we can get around it. Chase—particularly its lawyer—and David Rockefeller were not very aggressive in that respect. At Chase, the view was: If that’s public policy, if that is what they want to do, we’ll follow the rule. Citibank got ahead of Chase during that period because it was a more aggressive bank.

When I first became president of the Federal Reserve Bank of New York, Walter came down with his chief financial officer to explain to me, as a new Reserve Bank president, why Citibank didn’t need any capital at all. [Laughter] The only reason he kept any capital was because he had a few fuddy-duddy directors who insisted that he keep the capital. When you make money every year, you don’t have to have capital—that was his basic argument. They, in fact, had a low capital ratio then. The banks in general had let capital go way down. I think they let capital get down to less than 3 percent, maybe 2 percent. It was a struggle to get those capital ratios up.

MS. FOX. As the interest rate policy started to constrain the economy, and as the public became more vocal, assuming that populism was at work in the Congress, the relationships must have changed in those years.

MR. VOLCKER. I don't remember the sequence of time. It probably wasn't until late 1981 or 1982. There were a lot of state legislators passing resolutions to eliminate the Federal Reserve, and there were resolutions proposed in the Congress. I don't think any of them came to a vote, but there was talk about it. There was enough to cause some concern, but I don't remember any specific incident.

I was lucky, in the political context. The industry that was most affected was the homebuilding industry. There were a lot of complaints. The president of the homebuilders was understanding. He would meet with me and complain, but he never pushed all that hard. There was strong opposition, but we could have had a much nastier situation with the homebuilders than, in fact, I had. In or around 1982, they invited me—and I think they did it more than once—to address their annual meeting. I went to their annual meeting in Las Vegas. I ran into some congressman, who said, "Why are you out here? They will ride you out of town." He was not a friend of mine. I'm not that great a speaker, but I remember that they stood up and applauded at the end of my speech. I'm sure I told them that we were going to get through this. You've got to stick with it for a while, but when we get through it, everything is going to be better for the country and for homebuilders.

What I consider my greatest political triumph stems from when I was in a Board meeting, and Joe Coyne told me there was a group of community activists surrounding the building, led by Gale Cincotta, who was a well-known community organizer from Chicago.⁵⁵

⁵⁵ Joseph R. Coyne was an assistant to the Board in the Office of Board Members.

MS. FOX. She was known as the “mother of the CRA” (the Community Reinvestment Act of 1977).

MR. VOLCKER. They wanted to come in and talk to me. Against Joe Coyne’s advice, I said that when the Board meeting was over, I will meet one or two of the leaders in the office. When the Board meeting was over and I walked into my office, there were maybe 15 or 20 people. They were lounging, sitting on the floor, sitting in the seats.

We had a discussion. Gale was complaining. I said that we can look into this and look into that, and we agreed that I would send people out to some meetings. We could do something about the mortgage market around the edges, but I don’t remember what it was. We’d go back, and we’d look at that and see if there is something we can do. She said that I had to go out and tell her people. And she became friendly and stopped being aggressive.

So I went outside the back of the Board building, and the television cameras were there. Gale said that she just had a conversation with me, and we had a constructive discussion. She said that I was going to meet with them and have my people meet with them, and they all began applauding. This was the big story on the evening television. [Laughter] Maybe I said that we had a nice meeting, and we were going to meet again. I turned on the evening television, and it was community activists applauding the Federal Reserve.

When the savings and loan crisis began, some state-chartered savings and loans were either uninsured or poorly insured. There were a lot of failures. I spent a fair amount of time trying to do something about these events in Ohio and elsewhere. I sent some people to consult with the Ohio Governor and so forth and so on. I don’t think we actually did much in the end. There was nothing much we could do. But there was a rather assertive, liberal congresswoman from northern Ohio—Marcy Kaptur. She became my friend. She said that the Fed was the only

government agency that paid any attention to them and helped them. I'm not sure we could do much more than provide tea and sympathy.

I don't remember sitting down and strategizing about how we deal with the Congress. Ken Guenther was very experienced, but he didn't stay very long. He was important during the effort to enact the Monetary Control Act. Then we got Don Winn, who had been number two. I remember wondering whether Don was experienced enough to do the job of heading up the Public Affairs Office. In my opinion, it turned out great, because he was "the world's last honest man" kind of thing—he exuded straightforwardness and inspired confidence among [the] staff and the Congress that we were honest. Joe Coyne wouldn't let me say anything that he considered misleading or less than frank. He was always careful about what I said in public, ensuring that my statements wouldn't be misleading. It turned out that I had two good protectors in Don and Joe.

MS. FOX. What about the role of your general counsel, Michael Bradfield?

MR. VOLCKER. Mike Bradfield is a different character. I know Mike well, and I'm in close touch with him now. He was very much a loyal protector, and he was very aggressive about it. He would be aggressive with the Congress and the staff about legislation or other negotiations. He was a real bulldog, but he also did not mislead.

MS. FOX. There were activities in the Reserve Banks to increase and enhance educational outreach. I believe it was in 1977. The president of the St. Louis Fed, Lawrence K. Roos, led an effort to create a new outreach program to the general public.

MR. VOLCKER. A number of the banks did that.

MS. FOX. Joe Coyne and his small staff were supposed to help and even judge the effectiveness of Reserve Bank outreach programs. Do you recall any of that being part of your portfolio?

MR. VOLCKER. No. Most of the Reserve Banks have always had some kind of public relations program and outreach program. I don't remember a special program. There may have been, but I have no memory of it.

I want to go back and say something about [the] Congress. The nicest thing that happened to me in terms of the Congress was late in my second term. I didn't want to be reappointed and would have resigned earlier for family reasons or boredom, but there was some uncertainty, as there always was. My term was up in August of 1987. And around May or June, it started: "Oh, the Chairman needs to be reappointed" or not and so forth and speculative leaks from the White House. I got a call from Robert J. "Bob" Dole's office. Dole was the Senate Minority Leader [from January 1987 to January 1995]. He asked me to meet with him. I did, and he had a half-dozen or so major senators there—Warren Rudman and three or four others. These were key figures in those days. They said that if I wanted to be reappointed, they would fully support me.

I think I know who had the idea. Senator Rudolph E. "Rudy" Boschwitz from Minnesota was a friend of a friend of mine. I met Rudy at a friend's house when I came to Washington as Chairman. Rudy was always friendly. He was a brand-new senator and not very influential. But I think he suggested to Dole that he have that meeting. Rudy was there, but he was junior to the other people who were there. The group undoubtedly had some thought that there were some people in the White House who didn't want to reappoint me. I don't know if the President was involved or not.

By my nature, I didn't have close, personal relationships with many members of the Congress. I was not a part of the social circle in Washington. My wife wasn't around most of the time. If she had been around, it would have been a big help, I guess, but she was not. I went to dinners and so forth, but I didn't have any private social life, so to speak. And I went home to New York on weekends when I could.

MS. FOX. You said a lot of meetings appeared on your calendar. Presumably, Ken Guenther and, later, Don Winn worried about that schedule.

MR. VOLCKER. We decided to arrange some meetings and invite members of the Congress for dinner. We did that a few times, but it didn't work out. We didn't get much attendance, and I guess we just dropped it. But we did make that effort. I don't remember just when.

MS. FOX. Were there occasions when you invited a member of the Congress to speak to the Reserve Bank chairmen?

MR. VOLCKER. Yes.

MS. FOX. So you would reach out that way.

MR. VOLCKER. Yes, we did that once in a while. And if they wanted to come and have lunch or something, we did that. Senator Jesse A. Helms used to come to lunch once in a while. He was not a great natural friend of ours, but he wasn't a natural enemy either.

MS. FOX. He wasn't on the Banking Committee.

MR. VOLCKER. No. He stayed off of our back. Senator John Stennis helped a lot. When things were very tough in 1981 and 1982, some Senate hearings were antagonistic. Senator Stennis, who was not on the Banking Committee, sat in on the hearings obviously to show support for me. I didn't know him, but that's why he came. He had kind of an aura, as the

oldest man in the Senate.⁵⁶ People knew him, and they knew he came to show support. I don't think he ever asked a question. He came in and sat and, after a while, he went away. That happened a couple of times, right when it was the most tense. I didn't realize it at the time, but I did have a constituency, and the congressmen realized that.

Volcker Constituency and Advisers during the Inflation-Fighting Years

MS. FOX. How would you describe your constituency—the people who supported the Fed in the early 1980s?

MR. VOLCKER. I don't know. It was just middle-class America, a silent majority, I guess.

MS. FOX. People who worried about inflation.

MR. VOLCKER. Yes, people who were worried about inflation—those who felt that the country had gone downhill, and somebody was trying to do something about it. To some extent, they tempered the congressional reaction.

MS. FOX. Did you feel that the citizens of America trusted you?

MR. VOLCKER. I didn't know at the time. Later, when I met people, they expressed that sentiment. And from polls taken, when people were asked, "Who do you trust?" or something like that, I would be the one they mentioned. I would get these reports. There was some guy out in Pennsylvania—a friend of mine knew him. Apparently, he was a private pollster. He had a bunch of people calling people by telephone, and he would listen in at his home or in his office. Wherever it was, he listened to those calls and reported to my friend on how my standing was from all of these calls. This guy ran a commercial operation, and businesses hired him as a general pollster, but, incidentally, he would ask these other questions.

⁵⁶ John C. Stennis was a Democratic senator from Mississippi from 1947 to 1989.

MS. FOX. You were Chairman of the Federal Reserve at a time when there were some crises and mixed feelings in the Congress about you and about the institution. Aside from staff, to whom did you turn?

MR. VOLCKER. I didn't think of it that specifically. I didn't have any outside counsel. I relied on Joe Coyne and Don Winn. They would tell me what they had heard. And there were other staff people. But, staff people, by and large, didn't want to get into that kind of conversation—it was political.

I had a couple of friends who volunteered from outside—more than volunteered. Ed Yeo was around. He attached himself to me. He's very knowledgeable and very competent, but he's unconventional in some ways. He had a lot of journalist friends. Ed Yeo told me what was going on—who the enemies were, and who the friends were.

MR. SMALL. Was he inside the System or outside?

MR. VOLCKER. It was a bit strange. He succeeded me, once removed, at the Treasury as undersecretary for monetary affairs. That's when I got to know him. I was in New York then. He had been a senior banker in Pittsburgh, but he loved public policy and he loved intrigue. After he was undersecretary for monetary affairs, he was chief financial officer at a Chicago bank. The bank went bad—no responsibility of his—and I've heard all kinds of stories about that. He ran the Chicago school system one year.

Then he became a partner at Morgan Stanley, and when the Latin American debt crisis broke, he couldn't resist trying to "help," and he did help. He knew some of the Latin American finance ministers and central bankers, so he would meet with them to find out what they were thinking, or, if I had a message for them, he would deliver it. The Morgan Stanley people finally said, "Are you working for Morgan Stanley, or are you working for the Federal Reserve?"

So he followed his instincts and said he'd rather work for the Federal Reserve. He was a paid adviser at the Federal Reserve Bank in New York. I guess it was a full-time position. After I left, he continued there for a while. He was here not infrequently. There was nobody else outside the Fed who was so active in support. I had old friends from New York who I would talk to every once in a while. They would come down and talk to me. But there was no one apart from Ed Yeo who I saw so regularly.

MS. FOX. What about elder statesmen—people who were older and who had been around Washington?

MR. VOLCKER. By that time, I had been around Washington longer than most people. Henry Fowler, the old Secretary of the Treasury, was a good friend and mentor back in the Treasury, but he was up in New York at that point. After a while, I saw a lot of Bill Martin. I don't know if he gave me good advice or bad advice. He always told me not to stay too long! His health was deteriorating then, but when I got really frustrated, my secretary Catherine Mallardi would tell me to go and see Bill Martin. He was very simpatico. George Shultz had become Secretary of State. Barber Conable was helpful in the Congress.

MS. FOX. While you were Chairman, were there people at the Fed with whom you had trouble?

MR. VOLCKER. I eventually had some trouble with some Board members. But I don't think there was anyone on the staff that I couldn't trust. I was lucky. William "Bill" Taylor, the director of the Board's Division of Supervision and Regulation, was terrific. There was some nervousness when his predecessor John E. Ryan, who was well respected, had to leave, or left for

personal reasons, and Bill was second in command as deputy director, but Bill turned out to be terrific. And he became very close to Mike Bradfield. They were a duo.⁵⁷

Edwin M. “Ted” Truman I trusted absolutely.⁵⁸ But Ted was pretty much on the international side. In a way, I was closer to Truman and some staff than to others. Jim Kichline was very good in running research, but we did not have the same close relationship. Steve Axilrod was the top staff person on monetary policy and was indispensable. I may have suspected the judgment of some staff [members], but I could trust them to be open and loyal to the institution. It’s strange that in an organization that big, I can’t think of anyone I didn’t trust within the organization other than a very few Board members.

MR. SMALL. Can you contrast decisionmaking as Chairman of the Fed with decisionmaking at Treasury?

MR. VOLCKER. The Federal Reserve had an atmosphere, maybe less so now, of being academic and a little insulated from the real world. It would take time to make decisions. Things were studied endlessly. It was a cautious attitude in every direction. That was quite different from the Treasury. There we had a smaller staff. The staff was, in some sense, less influential. You had people coming in and going out at the policy level, and things were more informal. It was a “quick on your feet” atmosphere instead of the more bureaucratic-laden Board environment.

MR. SMALL. Did you have a sense that, at the Board, the decisions were based less on political factors?

MR. VOLCKER. I can’t remember any occasion when I had direct political pressure on a supervisory decision affecting a particular institution. You would get it on a general

⁵⁷ Michael Bradfield was the general counsel for the Board of Governors.

⁵⁸ Edwin M. “Ted” Truman was the staff director of the Division of International Finance.

rulemaking, but not “What are you doing to the First National Bank of Alabama?” or something, or “Why are you screwing my constituency over here?” I never had that.

I had a feeling that the Congress had an instinctive respect that you don’t play politics with the Federal Reserve. I don’t want to exaggerate the difference too much, but I think that most agencies with regulatory responsibilities are much more directly pressured than the Federal Reserve. I can’t imagine the Federal Reserve being involved in something like the Keating Five, where poor Edwin J. “Bill” Gray was chairman of the Federal Home Loan Bank Board and a strong and honest leader, and was told to lay off whatever it was called or we’re going to boot you out of town.⁵⁹

⁵⁹ The Keating Five involved five U.S. Senators accused of improperly aiding Charles Keating, chairman of the failed Lincoln Savings and Loan Association, which was the target of an investigation by the Federal Home Loan Bank Board. It was a political scandal that resulted in a lengthy Senate Ethics Committee investigation.

July 28, 2008 (Fourth Day of Interview)

MR. SMALL. Today is July 28, 2008. I am David H. Small. I am joined by Lynn Fox of the Board staff and Robbie Colby, a summer intern at the Board. We are continuing our interview with former Board Chairman Paul A. Volcker as part of the Board's Oral History Project.

Pressures on the Chairman

MR. SMALL. According to Bob Woodward, in the summer of 1984, you were asked to go to the White House to talk with President Reagan and perhaps others about the economy.⁶⁰ Do you remember that meeting?

MR. VOLCKER. Yes, it is engraved in my mind.

MR. SMALL. Who was there?

MR. VOLCKER. President Reagan and then Chief of Staff James A. Baker.

MR. SMALL. Was that unusual?

MR. VOLCKER. Yes.

MR. SMALL. Was it unusual because there were only the three of you?

MR. VOLCKER. It was also unusual that we met in the White House library. Whatever taping machines they had were probably not in the library.

MR. SMALL. Did you walk into the room feeling that they were especially serious about something?

MR. VOLCKER. I don't recall, but I presumed that they wanted to talk about my monetary policy.

MR. SMALL. Do you remember how it went?

⁶⁰ See Woodward (2000, pp. 15–17).

MR. VOLCKER. I sat there. President Reagan didn't say anything. Baker said, "The President wants to give you an order," which startled me. [Laughter] He said the President didn't want interest rates to go up before the election, which left me absolutely speechless, because at that time I had no thoughts of tightening.

MS. FOX. Was the tone of that comment—that the President wants to give you an order—"Don't raise interest rates before the election"? Was it forceful or jovial?

MR. VOLCKER. It was not jovial, but President Reagan's silence seemed to reflect some discomfort.

MS. FOX. He was not teasing in any regard?

MR. VOLCKER. No. As I recall, the market had tightened. I think it was the summer after Continental Illinois went bust, and bankers were nervous about lending to each other. As a result of that event and because we were following our operating policy of nonborrowed reserves or whatever, the increased nervousness in the market led to an actual tightening of the federal funds rate. I can't remember exactly what was happening in the economy, but my own opinion was that we didn't want a tightening. The tightening of the market was just a side effect of the Continental Illinois disturbance.

I don't remember the economic forecast. I can't remember the exact timing. But to get this order that interest rates were not supposed to go up [laughter]—what it told me was how out of touch they were with what I was really trying to do. I didn't confide in them. I suppose they got concerned because interest rates were going up.

MS. FOX. It was a market effect, but did they think that you would not counter it?

MR. VOLCKER. It was purely a market effect. Some people on the FOMC argued that if we tried to get rates down, that would give an easing signal, and we didn't want to give an

easing signal. So there was some confusion. Anyway, we eventually brought interest rates down a little bit.

MR. SMALL. Was that “order” almost counterproductive, in that now—

MR. VOLCKER. [Laughter] Exactly, because I didn’t feel like saying, “Mr. President, we’re going to bring interest rates down!” [Laughter] He would have taken the credit for it. So I didn’t want to say that. I was not about to say “Yes, sir.”

MR. SMALL. What about “No, sir”?

MR. VOLCKER. I didn’t want to say that we were going to raise rates, because we weren’t. So as near as I can recall, I said nothing. The question was whether or not I should go back and tell the FOMC. I decided that would raise unnecessary issues.

MS. FOX. Who did you tell?

MR. VOLCKER. No one. There was a serious question as to my responsibility to inform Senator Proxmire, who had extracted a promise from me to report any political pressure on policy. I decided that since the “order” conveyed by Baker had no practical influence, the risk that the incident might become public would raise more questions than could be answered and in the end hurt the Federal Reserve. I wonder to this day if that was the correct judgment.

MS. FOX. And then Baker and Don Regan switched jobs. Jim Baker became the Secretary of the Treasury in February 1985, and his predecessor as Treasury Secretary, Don Regan, went to the White House. Right after that, you and Baker coordinated the Plaza Accord.⁶¹ And according to your book *Changing Fortunes*, Baker said to you that this plan with

⁶¹ The Plaza Accord was an agreement signed by five nations—the United Kingdom, the United States, West Germany, Japan, and France—on September 22, 1985, at the Plaza Hotel in New York City. “The G-5 issues its first public statement, secretly negotiated over the previous three months, declaring that the dollar is too strong and no longer reflects ‘fundamental economic conditions’ and calling for ‘orderly appreciation’ of other currencies against the dollar. The United States agrees to take part in coordinated exchange market intervention” (Volcker and Gyohten, 1992, p. 357).

the dollar would be undercut if monetary policy was tightened. That was much gentler than the meeting in the White House.

MR. VOLCKER. We were talking about dollar policy. Baker said, “We can’t proceed with our effort to depreciate the dollar if you tighten money.” We had no intention of increasing interest rates in the short term, but I wouldn’t promise beyond the near term.

MR. SMALL. What kind of relationship did you have with Baker when he became Treasury Secretary?

MR. VOLCKER. It was a better relationship than it should’ve been. Baker was an experienced operator. He could be manipulative, but he was not confrontational. In that particular 1984 meeting, he was confrontational in the middle of an election, but that was the only time he was confrontational.

MS. FOX. Was there a follow-up to that 1984 meeting with Baker and the President?

MR. VOLCKER. No.

MS. FOX. Was the goodbye awkward?

MR. VOLCKER. It was a bit awkward, yes. What struck me at the time was that the President didn’t say a word. Usually, in those days, it was clear that he had the party line, which he wouldn’t express all that aggressively: “What’s happening to the money supply, Paul?” In those days, money growth was a little lower, and I would answer. And then, of course, he wasn’t really familiar with the explanation, so the conversation never went any place. In this case, he didn’t say anything. So I said to myself, “He’s uncomfortable with this.” I still believe that.

MR. SMALL. Over your career, did you talk policy with Lyndon Johnson and Richard Nixon?

MR. VOLCKER. Not much. At one meeting in the White House, I was there and Martin was there, and Johnson made it clear that the Fed shouldn't raise the discount rate. In various versions of stories, Johnson later accused Martin of subverting the whole presidency of the United States. It certainly was a confrontation. It had a little element of give-and-take. But in the 1984 meeting I had with President Reagan and in which Baker said an order was given, there was no room for give-and-take, because the "order" had no significance for policy. If I was intending to raise interest rates, there would have been a confrontation.

MS. FOX. I have to assume that people in the White House who were economists or were following the Fed or reading the newspaper would have made sure that Baker had a general understanding of what was going on in the marketplace.

MR. VOLCKER. In retrospect, the sensitivity before the election was entirely unnecessary on that particular question—Reagan was so far ahead of Walter Mondale. But they're always nervous before an election. Interest rates had gone up a little in June and July. Apparently that caught their attention, as it did mine.

MR. SMALL. In 1984, the target for the federal funds rate went up in the spring and summer and then started coming down in September.

MR. VOLCKER. What happened in June? When was Continental Illinois?

MR. COLBY. Around mid-May.

MR. VOLCKER. From the minutes of the [Federal] Open Market Committee meeting at the time, there is some discussion about the market tightening and why and whether that was just a reaction to the Continental Illinois disturbance, which I think it was. There was some question about whether to do something about it, which I probably raised. Some of the Committee members said we shouldn't touch whatever target we were using.

MR. SMALL. Here are the two long bond rates for the 10-year and the 30-year.

MR. VOLCKER. We were already looking at the federal funds rate.

MR. SMALL. And here's the funds rate, and then here's Continental. [Mr. Volcker is being shown some charts on interest rates.]

MR. VOLCKER. I don't know what the scale is, but it looks like the funds rate might have gone up more than ½ percent.

MS. FOX. So the Administration would have gotten nervous.

MR. VOLCKER. The chart shows the funds rate went up in June and continued in July and August. I didn't like that, at least not that much. So the question was whether to ease, whether we were using net borrowed reserves or borrowed reserves or something as the operating target, in order to moderate the increase in interest rates. There was a bit of a tussle. The Open Market Committee met about it for a couple of months. And in the midst of all that, I suppose that Baker saw the interest rates going up. He didn't know why, and he didn't know about the talks that were going on not to increase but rather to lower interest rates.

MS. FOX. You said in your book that Baker didn't tell Reagan about the Plaza Accord until a day or two before.⁶²

MR. VOLCKER. That's what I understood. I kept asking him about all this ideology the Administration had before against intervening: "How are you going to pull this off? Is the President going to agree to this?" He said, "I'll take care of that," which, of course, he did.

MS. FOX. Is there any chance that Ronald Reagan said, "Jim, you have to do something about that Federal Reserve" or "What are we going to do about the Federal Reserve?" and Baker said, "Mr. President, we'll bring him in for a meeting."

⁶² See Volcker and Gyohten (1992, p. 243).

MR. VOLCKER. According to a book coming out arguing this, and from outsiders looking at the record, Reagan was basically supporting me all along.⁶³ That's not the way it appeared to me at the time, because of all this stuff coming out of the White House. But it is true that he never criticized me or the Federal Reserve, and, as sure as I'm sitting here, his staff was telling him to criticize us, particularly when things were getting tough in 1981 and 1982. He had every reason to criticize us openly, but he never did. There were these anonymous things from the White House. But it never came out from the mouth of the President, which I think was not insignificant. There was at least one public statement as the unemployment rate rose to 9 percent that was fully supportive.

To me, Reagan was a very direct, simple-minded person, in a good sense. He would tell stories about his professor in college who told him that inflation was a bad thing. He felt that inflation was a bad thing, and I suspect his general instinct was: "We've got some inflation, and somebody's trying to do something about it. I don't understand it all, but why should I criticize the people who are trying to do something about it?" That was very important. It wasn't always public support, but it was enough.

MR. SMALL. President Reagan had reason to criticize you not only for tight monetary policy, but you were harsh on deficits, weren't you?

MR. VOLCKER. Yes, that was very tricky. A new, popular President came in and reduced taxes. Criticizing that directly didn't strike me as all that productive. It was all right with me to reduce taxes—if you reduce expenditures just as much. Of course, that's not going to happen. That was the only line I could take.

⁶³ See Samuelson (2008, pp. 105–16).

That tax thing was interesting, because it turned out to be a much bigger tax cut than Reagan originally proposed. He proposed a tax cut. The Democrats opposed it, and I don't remember what the alternative was. Then there was a deal in the making: The Democrats would accept Reagan's tax cuts, but with a cutoff date at some point, if I remember. It depended upon what would happen to the budget, but taxes would revert if the deficit rose. They tried to work out a deal.

I remember being in Treasury Secretary Regan's office. He was trying to negotiate this. He got a call from whomever the chief Democrat was who, in effect, said that the deal was off. That was the turning point, because then the Democrats competed on how big the tax cut would be. The tax cut wasn't twice as big, but it was a lot bigger than what Reagan originally had suggested, because the Democrats were going to add their own tidbits to it. What passed was a much bigger tax cut, because both sides were competing to increase the tax cut.

MS. FOX. And, in the end, there was no trigger, no review mechanism.

MR. VOLCKER. Yes, that's true. One or two years later, they took some of it back. That was a big tax increase; about half the tax cut was taken back. All I could do was worry about the deficits, which were terrible.

MR. SMALL. In 2004, Joseph Treaster wrote *Paul Volcker: The Making of a Financial Legend*. In the foreword, Arthur Levitt says, "Without Paul Volcker's toughness and guts, we may never have broken the grip of rising inflation and declining productivity that plagued the United States during the '70s."⁶⁴ As you tell it, you didn't get a lot of pressure from Presidents Reagan or Carter. And you haven't revealed that much stress dealing with the Congress.

MR. VOLCKER. It was all a piece of cake. [Laughter]

⁶⁴ See Treaster (2004, p. ix).

MR. SMALL. Where was the Volcker toughness and stick-to-it attitude?

MR. VOLCKER. It was one of those times. Like I can tell Barack Obama, things are going to be a mess when he takes over. This will give him an opportunity for doing things that would never be possible otherwise. We were in that kind of a situation. You could do something that would have been out of the question two or three years earlier because, back then, people were not upset enough to take all this.

MR. SMALL. I could see how that would lead to the need for toughness when facing all that uncertainty of how this would work out. But were you under great pressure from the Congress, or just from watching the unemployment rate rise?

MR. VOLCKER. Yes. It wasn't a great thrill to pick up the papers. A cement company used to take out full-scale advertisements with skull and bones and with me as Darth Vader.

MS. FOX. When I was on the Hill, many said that Paul Volcker doesn't look out the window when he makes monetary policy. The feeling was that you were intentionally or unintentionally neglecting the harm that your crusade was causing in individual lives.

MR. VOLCKER. There was no question. I remember one of my assistants coming in one day and asking, "How do you feel when you know you are preventing old people, who have saved up for retirement, from buying their house for retirement?" I mean, once you've launched this attack, you have launched it, and you want to carry it through. The answer you have is that it's good for the country in the long run. It will come out okay. You're telling yourself that, but if you think it was not ulcer producing, you are quite wrong.

MR. SMALL. You worked late hours. What would you need to work on? Set the federal funds rate or set the money target, then that was it? Was it following the economy day by day, answering questions?

MR. VOLCKER. [Laughter] Well, I took a certain amount of work home at night. You did what you could to explain yourself, quiet people down, and so forth. However you do it, you do the best you can.

MR. SMALL. That was after a policy decision. How much of your time did you spend looking and thinking about the next move in monetary policy?

MR. VOLCKER. I found the job a bit of a bore in ordinary circumstances. Once interest rates got down and things were fairly calm, you'd go from one FOMC meeting to another, and there wasn't much to do. There were small shavings of policies. I don't understand how Greenspan stood it for 19 years. To exaggerate a bit, for 15 of those years there was nothing to do.

There was legislation on the table when I came to the Board, and that took some months. There was a lot of lobbying on the Hill and so forth. My time was absorbed much more with the Latin American debt crisis than it was with monetary policy per se. Contact with all these Latin Americans, the Congress, and the banks here in the United States took a lot of time. That lasted until 1984, 1985. After that calmed down, there wasn't as much to do.

MR. SMALL. Quoting from Treaster's book, when you were in front of a congressional committee, "The Congressmen literally shrieked. Frank Annunzio, a Democrat from Illinois, shouted and pounded his desk. 'Your course of action is wrong,' he yelled, [his voice breaking with emotion]. 'It must be wrong. There isn't [anybody who] says you're right.' . . . [A] Republican from Idaho [said,] '[We're] destroying Middle America,' . . . '[we're] destroying the American Dream.' " Henry Gonzalez asked for your impeachment. He talked about how you

had permitted the big banks to be “predatory dinosaurs that suck up billions of dollars in resources.”⁶⁵

MR. VOLCKER. Rather like what it is today, in terms of the predatory people on Wall Street.

MR. SMALL. Were you worried that the view being presented by Congressman Gonzalez was going to take hold with the public?

MR. VOLCKER. Yes, I was worried. How could I not be worried? You try to deal with it.

I don’t think there was anything very specific. You meet with your opponents, that’s for sure. The farmers would come in, and they would be all upset. There was not much you could do. I was not going to change monetary policy because of the farmers’ distress. But we had little gestures on the discount rate, such as opening up the discount window for the agricultural banks, extending seasonal credit—I can’t remember all the things we did and the devices we used once in a while. That really didn’t affect overall policy, but it made them feel that maybe they were being listened to, and that there was some relief being given within the limits of policy.

I don’t remember if we could do much with homebuilding, but I do remember agriculture. And there may have been other areas where you could give a little on nonessential things if it was not creating too bad press. It would help. These people would come in. I’d listen to them, and I’d have a good story for the outcome, I thought. The homebuilders would come in, and the farmers would come in. We’d sit down around the Board table, have a discussion, and they would see I didn’t have horns, and they’d go away.

⁶⁵ See Treaster (2004, pp. 4–5).

MR. SMALL. Did you understand their distress?

MR. VOLCKER. Of course I understood their distress, but what was I going to do about it?

MS. FOX. Did you feel like a wartime general would feel?

MR. VOLCKER. Not necessarily. But it was sort of like: President George W. Bush was already in trouble in Iraq, he wants to see this thing through, and so he has a surge. It's the same kind of mentality.

MR. SMALL. Some say you didn't ease policy early enough, quickly enough.

MR. VOLCKER. I know. That was a real dilemma at the time, because I was getting sick and tired of the recession. As I said, there was a feeling the recession was going to stop in the first half of 1982. Earlier in these interviews, we talked about this. On the FOMC, we had this dilemma that the money supply was high, and we didn't want to give a signal of easing prematurely. The economy was worse than we had anticipated. It was getting pretty dicey then. That's why we eased so quickly, as soon as we had our money supply excuse. And it only took about one week for the money supply to go below its target, and "Let's get the interest rate down a little bit." We didn't do much, but the market took that as a signal that it was the end of tight policy, and then it got easier.

MR. SMALL. The bond rates came down quickly.

MR. VOLCKER. Yes, they came down quickly. The economy didn't really begin to recover, but the pressure was off then, because the market was easing so rapidly. The economy continued to decline, but everybody foresaw the end of the distress, so the pressure came off. And then the economy began rising very rapidly in the next year.

MR. SMALL. The bond rates stayed down for quite a while. Did you take that as indicating a breaking of the high-inflation expectations?

MR. VOLCKER. Oh, I don't remember. The inflation rate was coming down in the second half of 1982. The pressure was off the market. We finally gave a little easing signal; the money supply temporarily had looked okay. The inflation rate began to come down, so everything was easing. The trouble was that the money supply began exploding. So what do we do? That got back to this great press conference where I made an analogy to being in a house.⁶⁶ We were moving from one room to another, but the policy was the same. And that was the big struggle, because we put all this weight on the money supply, and the money supply was going through the roof. There was a lot of discussion in the FOMC. How can we leave our money supply home without looking like we're giving up?

MR. SMALL. I'm looking here at some charts on the money target ranges over 1979 to 1982. It starts out with the definition of old M1, then it shifts to M1B, then to M1B shift-adjusted, then to M1. There was an M1A in there.

MR. VOLCKER. I don't remember the details, but NOW accounts were being introduced, and other technological change was going on in the market that affected how you count the money supply. Did you put in NOW accounts or not put in NOW accounts? That was M1A and M1B. And it was a struggle as to what the right definition was.

MR. SMALL. So if you look at the plain macroeconomic time series after 1982, things looked pretty good.

MR. VOLCKER. Yes.

⁶⁶ See Volcker (1982a, p. 6).

MR. SMALL. But if you look at the list of financial crises—Penn Square, Mexico—this tightening certainly had its effects on the financial system.

MR. VOLCKER. Texas was kind of *sui generis*. You had this big oil boom. Texas and Oklahoma went wild building office buildings—all these so-called see-through office buildings. They were empty. At the time, I met [Gerald D.] “Gerry” Hines, a big real estate developer and an astute guy. He was on the board of the Federal Reserve Bank of Dallas. He would tell me how foreign investors were offering him money practically for nothing. He didn’t want to borrow, because he thought it was a big bubble, which it was in Texas and Oklahoma. Penn Square was a reflection of that—nothing to do with general economic policy.

MR. SMALL. Except it was policy and the weak economy that caused oil prices to come down.

MR. VOLCKER. That was the equivalent of subprime mortgages now—it was bound to collapse.

Financial Crises in the 1980s

MR. SMALL. In your book *Changing Fortunes*, you wrote, “I do recall, at a seminar at the London School of Economics when I was a graduate student, being exposed to the then-conventional wisdom: If international loans are to be made in any volume by *private* lenders . . . it should be done by banks. . . . That lesson was drilled into my mind: Large-scale international lending, if it is done at all, should be done through syndicates of banks that are able to assess risk expertly and carefully, and, if worse came to worst, work together to organize debt restructurings in their common interest. What I learned not as a student but as a central banker was that it was impossible to count on the first of those precepts.”⁶⁷ Do you think that was a valid framework?

⁶⁷ See Volcker and Gyohten (1992, pp. 189–90).

MR. VOLCKER. I still hold to it, except that technology has overrun it. The banking system is not what it was, but I think you see some symptoms of that now. Credit has escaped the banking system, and it's hard to organize a rescue package in an orderly way when that has happened. I think that's still true. It's gotten much more complicated. But I was talking then about international lending.

I don't know why that statement impressed me, but it did impress me. In 1951, this banker came in—and you still had people who remembered 1929—the great crisis and so forth. This guy argued that what happened then was, credit got outside the banking system and got outside an orderly reorganization. That's what happened then. I would think that there's something to it. If there had been a similar amount of Latin American lending outside the banking system in the early 1980s, we never could have managed the debt restructuring. You couldn't manage it today inside the banking system, probably, with marked-to-market accounting and all that stuff, which we deliberately did not follow during that period.

1980 Credit Controls

MS. FOX. In March 1980, President Jimmy Carter issued an executive order announcing credit controls. How did you work through the credit controls with the FOMC?

MR. VOLCKER. The FOMC wasn't particularly involved. The credit controls were the Board's responsibility, not an FOMC responsibility. I'm sure it was discussed in the FOMC, but it was for the Board. The basic story was, we tightened a lot. Interest rates were sky high already. As I remember it, there was some confusion when I was writing the book *Changing Fortunes*. As I remember it, the Carter budget, which was announced in late January, was greeted with great cynicism by the market. And it poured fuel on this fire of high interest rates. Inflation was going to go on forever, and so forth and so on. Carter and the White House people

understood this, and Carter decided to rewrite the budget. And he wanted to get me involved in support of this effort, because he wanted to get some credibility.

MS. FOX. And why were you credible on this topic?

MR. VOLCKER. Well, by that time, I had become credible with tight money. I was seen as a tough guy. So Carter asked me to go with his people to talk to the congressional leaders, and I went once or a few times. But I just sat there, not knowing what to do, because the budget was not my thing. I would say, "Yes, it's important to tighten the budget," but I don't remember participating much.

MS. FOX. Were there any conversations between you and people here at the Board about whether it was appropriate for you to tag along?

MR. VOLCKER. I don't remember any particular discussion about that. They must have known it, but I don't remember ever sitting down and debating whether I should do this. I did sit in on the budget meetings, in any event. I was uneasy about it, but what could you do? I didn't want to say, "No, Mr. President, I refuse to go up there and talk to the congressmen about the importance of a strong budget program." He finally sat down to make his budget decisions. He had his top people there, and he wanted me there. Again, I don't remember doing anything except sitting there.

Carter went through the budget line by line. Stuart Eizenstat was Carter's chief domestic policy adviser, and he said, "Mr. President, there's a line here suggesting to cut expenditures for antipoverty programs by \$400 million." I am making up the figure and loosely quoting. Carter would say, "Okay." And then Eizenstat would start: "You don't want to do that, there's a lot of support for these programs. Do you really want to do that, Mr. President?" Carter would say, "Yes." Eizenstat would then say, "You really want to?" Finally, Carter would say, "Well okay,

make it \$300 million.” We went through all of this, and then Eizenstat would come back and say, “I want to go back to this poverty program. You really want to do this, Mr. President?”

And Carter put back another couple hundred million dollars.

MS. FOX. So here is exactly a parallel situation, where President Carter needed to do some tough things to fix a big mess.

MR. VOLCKER. My impression of Carter from this meeting was that he was conservative in his own instincts, but he kept getting pulled in a different direction by the left wing of the party, and it ended up as kind of a mish-mash. It didn't satisfy anybody. It didn't satisfy his own instincts. It didn't satisfy the party.

Anyway, in the midst of all this, he gets this idea of credit controls—in essence, saying, “I'm under great pressure, and I must demonstrate that strong action is necessary.” There was a law that authorized the President to call for credit controls, and the Federal Reserve had the authority to administer them. At that point, with money very tight and nobody borrowing, formal credit controls didn't seem to us at the Fed to be the right approach. But the President wanted to send a message.

So I discussed the matter with the Board, and the Board members were all against credit controls. I didn't like them, but I kept the issue open. We told Carter, “We don't think you ought to do this, Mr. President,” but he wanted to go forward with credit controls. I don't know what he would have done if we said “no.” It would not have made him happy. We could have theoretically said, “You can call for all the credit controls you want, Mr. President, but we're not going to administer them.” I didn't think that was a tenable proposition. If he had been forced to back off, he would have been understandably upset. There we were, with 15 percent interest

rates or whatever they were, and he's rewriting the budget. He's unpopular, and the Board would be making life miserable for him. It didn't seem tenable to flatly oppose him.

We developed this idea that we'll have credit controls, but we will make them as little disruptive as we possibly can. The Board finally went along with that.

MS. FOX. How did that discussion go with the Board?

MR. VOLCKER. The Federal Reserve has a long history with operating credit controls.

MS. FOX. From war time.

MR. VOLCKER. And they went on for 10 years more after the war. Mortgage and consumer credit controls went on for quite a long while. We should still have them. [Laughter] They didn't stop right at the end of the war. They gradually got eased.

MS. FOX. So do you remember having to go talk to Board members individually, or just listening to them complain during the Board meeting?

MR. VOLCKER. I don't remember that we ever met individually, but it took some persuasion. I don't know what we could've done differently. The President felt he was in a box. I suppose he would have backed off if we said "no."

MR. SMALL. But he wasn't criticizing you publicly.

MR. VOLCKER. No, he was not criticizing us. He was leaning on us with this business about the budget and so forth. In essence, he was saying to the public: "We've got to do this budget restraint. The Federal Reserve wants it." He was not criticizing us despite the fact that money had gotten so tight. So what were we going to do, turn him into enemy number one? That seemed to me the kind of choice we had.

MS. FOX. Who was your key contact in the White House over all of this? Did you talk to the President a lot then?

MR. VOLCKER. There wasn't that much talking with the President directly. We were probably meeting as part of the Quadriad or something like that. Miller was Secretary of the Treasury. Lyle Gramley was still at the Council of Economic Advisers, I guess, at that point. Eizenstat was Carter's domestic policy adviser. What part they played is an interesting question. I think they were just passive. The President wanted credit controls. If they were arguing against them, it was a pretty passive arguing against them.

MS. FOX. Finally, you got the Board to go along. And you coordinated closely with the Administration, because the executive order announcing credit controls was issued on March 14, 1980, the same day that the Fed announced a tightening.

MR. VOLCKER. Yes, it was all coordinated. That didn't happen with the subsequent Administration, but I trusted the Administration. I had some old friends in the Carter Administration. We wanted to tighten money more. The President said, "I understand you're going to do that, but please wait until I can announce my new budget so we have a coordinated attack." The coordination was his idea: The Fed would raise interest rates, the Administration would have a tighter budget, and together we were going to announce credit controls. This would really make an impact on people. It did. [Laughter] That was his strategy. It sounded sensible to me, even though we did not like the idea of credit controls.

MR. SMALL. The specifics were very different, but you mentioned that you put a lot of things into the October 1979 procedures to make an impact.

MR. VOLCKER. Yes.

MR. SMALL. So this was kind of the same?

MR. VOLCKER. Yes. You had the Federal Reserve and the Administration working together to deliver the final blow against inflation. We convinced ourselves that we were getting

a public relations gain and whatever it was out of the credit controls. But, in fact, the credit controls would not be unduly restrictive. We exempted housing and automobiles; 90 percent of consumer credit was for housing and automobiles. So we decided, what harm can it do? Well, we found out. [Laughter] The controls mainly affected single-payment loans or installment loans not related to housing, of which there were not many. Credit cards were the biggest issue, but they were not so fully developed.

Credit card providers were mostly banks, but whether a bank or not, if credit card outstandings—the outstanding loan balances—went above the previous high point, the institution had to put up a 10 percent reserve requirement. In effect, it was a 10 percent tax if they went above the previous peak. We put this in knowingly when, seasonally, credit card balances were declining—they go up before Christmas, and then they go down for a few months. So the issuers had leeway. The department store people came in and said, “You can’t do this! What are we going to do?” I said, “What do you mean what are you going to do? You’re all below—nothing has to happen right now.” They said, “But what are we going to do next Christmas season when it goes up? We’ll have this terrible restraint.” Oh my gosh, I couldn’t imagine that credit controls were still going to be on by the end of the year. [Laughter]

When we began getting the figures, two things happened. All the money supply numbers, which we got right away, went down because people were using their checking accounts to pay off their credit cards. And then when we got the figures in some of the sensitive areas—I don’t remember whether we covered mobile homes or not, but in any event, mobile homes were very dependent upon credit. And mobile home sales suddenly dropped, and many consumers stopped using credit cards. The economy really came down, and it went into a recession. The money supply dropped, and everybody said, “Well, your operating procedures

are based on stabilizing the money supply, so you've got to ease policy." By the time we had clear evidence of the sharp recession, we took the credit controls off.

MS. FOX. And so how much did interest rates drop?

MR. VOLCKER. Rates dropped quite a lot.

MS. FOX. People stopped spending. The economy went into recession. You started lowering interest rates. This was in the spring of 1980.

MR. VOLCKER. We lowered rates more than we wanted, because there was all this pressure. And it seemed all along that the recession was kind of artificial.

MS. FOX. Meaning, artificially induced by the credit restraints?

Mr. Volcker. Yes.

MS. FOX. And that as soon as the credit restraints were gone—

MR. VOLCKER. Well, we weren't sure about that, but that's what happened. The economy rebounded.

MS. FOX. With whom were you working through the impact of all this on policy? Who was your brain trust about credit controls and how consumer spending was going to affect the—

MR. VOLCKER. It was confusing at first. Nothing like this had ever happened before. First of all, the money supply just plunged. Is this a statistical quirk? What is going on here? And then the sudden decline in certain aspects of business activity was startling. It wasn't the heart of the economy, but it was enough to make a difference. This was a good lesson in unexpected results of government intervention, no doubt about it. We thought we were leaning over backwards to moderate restraint from the credit controls.

MS. FOX. Do you think the error was in communications?

MR. VOLCKER. Well, what could you do? Carter couldn't get up there and make a speech, and then we would say, "Yes, we're putting on credit controls, but they're meaningless, don't pay attention to what the President just said." [Laughter]

I think it's inherent, when you have that kind of government intervention, that you be wary of what the effects may be. In this case, the Administration made a big deal about this, and everything was coordinated, and the credit controls had an impact that they would not have otherwise had. If you just put on the credit controls out of the blue, if you kind of snuck them out, the market probably would have thought, "Oh, the controls don't amount to anything. They're not real controls. They're not going to affect anything," and the general public wouldn't have understood them. But when there's a White House announcement, and you have all the press in the East Room, it is a big to-do.

MS. FOX. And people did what you told them to do about using credit, but they translated that into "Quit buying"?

MR. VOLCKER. They translated that in the moment, and they quit buying, that is correct. As I remember, demand for automobiles was not all that high at the time. Consumption was not a big problem, as nearly as I remember. We essentially said, "Consumption is not a problem, Mr. President," but no, he wanted to create a big symbol. I don't remember how much consumption actually went down. Some parts of consumption went down, I'm sure. We got a recession. Not a very big recession—a very sharp recession, but [a] short recession.

MS. FOX. How did you interface with the White House about addressing the recession? Were there intellectual debates about, what do we do now?

MR. VOLCKER. We put our money on the money supply, and then the money supply suddenly falls out of bed. You had a chorus of complaints, both from the monetarists and from

the other side who said, “All right, we will tolerate this experiment, given the inflation and all the rest.” I remember Alan Blinder—I don’t know why I remember him particularly, just because I knew him—he made a great point: “Look, we supported you on this tight money, focusing on the money supply, but now the money supply has fallen out of bed. You’ve got to respond very sharply and forcibly.” Both the monetarists and the others all joined in and said, “Ease up.”

MS. FOX. And you did.

MR. VOLCKER. And we did, but not as much as they would have liked.

MR. SMALL. The funds rate in late January 1980 was at 14 percent, and by June 5, it was in the 8.5 to 9.5 percent range.⁶⁸

MR. VOLCKER. That was quite a lot.

MR. SMALL. But then, in the summer, rates went up, and then there was the election.

MR. VOLCKER. We took off the credit controls in July. Then, although most people didn’t think so, we began getting evidence that the economy was coming back. We began tightening up as fast as we could. And we continued that in the middle of the campaign.

MS. FOX. You had to do what you promised. You had to lower rates. Did anyone argue to be cautious because we’re going to be lowering rates, these credit controls are going to have to come off, and then, whoops, we’re going to have an about-face?

MR. VOLCKER. There were probably people on both sides: people who said, “Let’s be cautious,” and there were convinced monetarist types on the Board who would’ve said, “Yes, we’ve got to play this game.” I don’t think anybody in April and May was saying, “We’ve got to get rid of the credit controls right away.” You had to leave them on for a little while, and nobody

⁶⁸ See Federal Reserve Bank of New York (2008).

knew quite what the economy was doing. I'm sure there was a division on the Board, but it wasn't, I don't think, intense.

More on the Volcker Chairmanship: Leading Up to the 1984 Presidential Election

MS. FOX. In these years when you were new to the chairmanship, having been on the FOMC due to your position as president of the New York Fed, did the FOMC immediately defer to your judgment, or did you feel them testing you?

MR. VOLCKER. Yes—on balance, they were supportive. Some of them may have liked it; some of them may not have liked it. It wasn't like I came in from outside. I had a lot of experience inside the Federal Reserve, and I'd also had a lot of experience outside the Federal Reserve, at the Treasury and so forth. I don't think anybody was going to challenge that I knew the Federal Reserve or that I knew policy or whatever. The liberal side was uneasy about it, at first, but not because of me.

MS. FOX. When those decisions were being made, did you feel that, as a Chairman, it was your job to make these decisions and then bring people along?

MR. VOLCKER. As I said before, my general attitude towards the Federal Reserve was that it's important to have a Board. I don't believe you should just have a Chairman who is making all these decisions. However, a Board is not going to work very well unless the Chairman has a lot of deference. The Board is there because you might get some real nut who pushes interest rates too high or too low or something—to provide a check on that. That's not the way most Board members would look at it, though.

MR. SMALL. It has been said that, when you came in, you were the best prepared Chairman ever.

MR. VOLCKER. Yes. You can argue about policy, but I knew Washington, and I knew the Fed.

MR. SMALL. But you also knew the details of the reserve market and how money numbers are put together.

MR. VOLCKER. Yes, I had a big advantage in that respect. I knew as much about the Federal Reserve as any of them did, and probably more, because I'd seen it from the Reserve Bank side, from the outside.

MR. SMALL. Mr. Chairman, I'll just note, your memory is correct. In May 1980, the Greenbook was predicting real growth of negative 1.8 percent for 1981, and that forecast was raised to negative 0.2 percent in the July 1980 Greenbook, so there was a large upward revision. The data must have come in pretty strong. Then you started raising interest rates.

MR. VOLCKER. Some banking delegation was visiting the Board. They were all pretty glum in telling me how bad the economy was at a time when I was becoming convinced that it was really coming up in August. It turned out we were right and they were wrong, but they were still pretty glum.

MR. SMALL. Other than the massive data that come in and the Greenbook, what were your other sources of information? Were you talking to businessmen?

MR. VOLCKER. At this occasion, whoever I was talking to was not giving very good information, because they were still being pretty depressed in August when I was beginning to feel better. Sometimes your old friends or somebody will call you up. Basically, at that point, it was just the data that were coming in making everything look a little better.

MS. FOX. In your book, you mention that, at that point, there was a presidential campaign going on, and, as a candidate, future President Reagan said that Fed monetary policy was too easy.

MR. VOLCKER. Good. That was a helpful comment. [Laughter]

MS. FOX. The presidential campaign was hard fought. And President Carter lost his bid for reelection to Ronald Reagan. As the Federal Reserve Chairman, part of your job is to stay attuned politically. What does a Fed Chairman do to develop relationships or knowledge about a potentially incoming President?

MR. VOLCKER. Well, in my case, I'm not very astute, so I did nothing. As near as I can remember, I'm sure I did nothing. At that time, my major concern was that we had been through the brief recession. We had done a lot of easing at that point, there was no impact on inflation, and we would lose credibility unless we responded pretty quickly to making up for this easing episode. We'd better get back on the ball. I think we were getting some smirking by people like Walter Wriston. We weren't doing anything. We'd eased a lot when the economy went down, and inflation didn't do anything.

MS. FOX. What was Wriston smirking about?

MR. VOLCKER. Wriston was always combative about the Federal Reserve, always opposed to the Federal Reserve, and this gave him a chance to criticize: "What were you doing? You're not tight enough" kind of business, or "You eased too much." Actually, we quickly got to the point where we tightened much more as the economy recovered even more rapidly than expected.

I thought there was a market credibility problem emerging at that point. We had tried very hard to establish credibility, and we were in danger of losing it. That was the main thing that I think was on my mind, election campaign or not.

We raised the discount rate very late in September, right? And that was the last chance we had to do it before the election, because we wouldn't want to do it right on the eve of the election.

MR. SMALL. Right before your last easing, bond rates had already turned up.

MR. VOLCKER. That was the credibility problem. I don't remember what happened then. I do think that we were worried about credibility. I remember having to testify. Maybe it was the next Humphrey-Hawkins testimony. It was interesting. We'd been through all this, and I remember [Fernand] "Freddy" St. Germain (Chairman of the House Committee on Banking, Finance and Urban Affairs from January 1981 to January 1989) pressing me about what I had accomplished in this past year. The answer was "not much." But I said something like, "It's partly a lost year because of this credit-control-induced hiatus." It was kind of a lost year, but people still stuck with it.

MS. FOX. That brings us to your September rate increase. You sat pat for the election, is that right?

MR. SMALL. In 1980, the discount rate came down through July, and then it went from 10 to 11 percent in September, and the funds rate was climbing up. That was the last discount rate increase before the November election.

MR. VOLCKER. After the election, we went at it hammer and tongs. Okay, so this is a kind of hiatus, but the election was over. Carter had nothing to say at that point. The

Republicans were saying we were not tight enough. This was kind of a pregame during that period.

MR. SMALL. There's the political argument for a new Administration that it is better off taking the pain early.

MR. VOLCKER. There's that, too. On the monetary side, many in the new Administration and their adviser Milton Friedman were zealots on monetary policy and the money supply. There was an informal meeting after the election, with talk about abolishing the independent Federal Reserve. Arthur Burns was there and came to see me. He was terribly upset and worried about this. Walter Wriston was part of that meeting, along with Bill Simon and others. I don't know how much of a real threat it was, but Arthur Burns sure thought it was a threat.

MS. FOX. In your book, you gave Burns some credit for helping.

MR. VOLCKER. Oh, no question. He was the only Republican insider there who revered the Fed. Arthur Burns, if nothing else, felt very strongly about the importance of the Federal Reserve, its independence, its competence, and all the rest. However he acted in terms of policy, he felt very strongly about the role of the Federal Reserve. And I'm sure he helped moderate this kind of heretical strain in the Republicans, which never included people like [Jim] Baker. Baker was not involved in this talk, and he became Chief of Staff in the White House. The pressure at that time did not come from the White House people, who were kind of pragmatists in this area. The Treasury people all dumped on the Fed, but we had the fortunate fact that the Treasury had both strong monetarists and supply-siders. They spent so much time disagreeing with each other that it moderated the joint attack on the Federal Reserve.

MS. FOX. What are your other memories of the election, of Carter's loss? Did you see him after the election?

MR. VOLCKER. I'm sure I did see him after the election, but I don't have any particular memory of it. He was very disappointed. Now the election is considered a great avalanche victory for Reagan. It didn't seem that way at the time. My memory was that it was quite close until right at the end. Carter thought that he was going to win, or at least had a good chance of winning, until right at the end. All the polls showed it much closer than it actually came out. It's probably one of these things where you had a change in public opinion in the last few days before the election. It was made to look like a landslide, but that's not the way it looked during the campaign.

MS. FOX. How did the Iranian hostage crisis and all those bad things that were happening during that period affect things inside the Federal Reserve?

MR. VOLCKER. That was so preoccupying that I think the Administration's mind was not on monetary policy, or economic policy in general, to the extent that it might have been. Even during that recession and all the rest, everybody was talking about hostages.

MR. SMALL. Was the Federal Reserve System involved in the details of the frozen Iranian funds and transfers?

MR. VOLCKER. Yes, but I was not. The Federal Reserve Bank of New York was quite involved in handling the funds in its role as fiscal agent of the Treasury. And there was quite a lot of secrecy.

MR. SMALL. The hostages were released on Inauguration Day.

MR. VOLCKER. Yes, they were. But when was all that money changing hands and so forth? There was a time when the New York Reserve Bank was involved, and there were very

confidential funds transfers. I think they had to go to some meetings in Algeria or wherever all this was being negotiated. I don't know if it was then or a little bit later, but I didn't have anything to do with it, personally.

The Chrysler Bailout

MR. SMALL. The Chrysler Corporation was close to bankruptcy in 1979 but was bailed out by loan guarantees provided by the federal government. What policy issues about the role of the Fed, "mission creep" and the like, were discussed?

MR. VOLCKER. There was much debate about bailing out Chrysler.⁶⁹ [Senator William] Proxmire was against a bailout. He took the position that if you're going to have a loan guarantee board, the Federal Reserve had to be on it. He didn't express it quite that way, but what he meant was, the only agency he would trust was the Federal Reserve. I took the position that I didn't think it was the Federal Reserve's business and the Federal Reserve shouldn't be on the board, but he said, "Too bad." [Laughter] He put us on the board. So, over my protest, the Federal Reserve was on the board. I think he was right, as it turned out.

The Secretary of the Treasury was the chairman of the board. The staff was hard working, and there was a good general counsel. They did a really good job. The Board had some responsibilities, too. I assigned Don Kohn to this job. I trained him; he got some extracurricular training. [Laughter] There was a woman, B. Eugenie Mallinson, who was around for some reason or another; she had good instincts. She had been in investment banking

⁶⁹ In January 1980, President Carter signed the Loan Guarantee Act into law. Under provisions of the act, a three-member board was set up with two advisory members. The board was headed by the Treasury Secretary and also included the Chairman of the Board of Governors of the Federal Reserve System and the Comptroller General of the United States. The Secretary of Labor and the Secretary of Transportation served as ex officio nonvoting members of the board. The board was empowered to review corporate decisions and supervise significant expenditures by Chrysler until the loans were repaid. See Bickley (2008, pp. 2–3).

or something at some point. They were the two Federal Reserve people who kept track of it for me.

It was important to have the Federal Reserve involved. The Secretary of the Treasury's staff was highly competent, but the Comptroller General was on the board, and I don't remember his staff being particularly helpful. He was preoccupied with whether the collateral was in order. He was being a good accountant: "We got the collateral for all these loans? Where's the collateral?" Every meeting was "Where's the collateral?" The Secretary of Transportation was an adviser, but he wasn't really heavily involved, nor was the Secretary of Labor.

One of Treasury Secretary Miller's main preoccupations was to get Chrysler merged. He went around trying to find some other company to buy it. Salomon Brothers was hired as the investment bank. James D. "Jim" Wolfensohn was the head of investment banking with Salomon, and he was supposed to find the merger partner. He was also supposed to coordinate the bank lending. That was his entry into Washington. Anyhow, I had the feeling that every time a really tough issue arose, they would ask the Federal Reserve to resolve it.

Lee Iacocca gets more credit than he may have deserved for his role during the negotiations. His major preoccupation, which I used to laugh about, was that he didn't want to give up the company airplanes that Treasury told him he had to give up as a symbolic thing. I think Iacocca was very important publicly as a salesman after it was done, but he didn't do much in the reorganization. In fact, he resisted all the reductions in size and so forth, but he was a great source of confidence for the company.

Negotiating with the labor union was a big problem that Iacocca didn't want to touch. Nobody wanted to touch that. So I was left to negotiate with Doug Fraser, the head of the UAW [United Automobile Workers], which I didn't think was all that difficult. Nobody else wanted to

talk to him. I remember him coming into my office. I told him straight up that this is what you've got to do, as the law required. He tried to negotiate, but I indicated that to make this thing all hang together, this is the way it's got to be. He accepted that in the end. I've heard him say, "He is the toughest guy I ever negotiated with." But I had all the cards. He had none of them. [Laughter] He had to cooperate to get this thing done. The Canadian union was tough. We didn't have the same handle on it.

The banks never got together until the end. I had to meet with the banks, and I told them the same thing I told Fraser: This is the way it's going to be. This is what you've got to give up and what you're going to get in return. And, if they hung on, they would make money, because they got warrants. And if they hadn't sold their warrants right away, they would've made a lot of money, as the government made a lot of money in the end. This was all done in 1980. It was pretty much a success by the time the new Administration came around.

Iacocca demanded a meeting with the loan guarantee board to say that it was unfair for the government to profit from all these warrants. He wanted us to eliminate the warrants. Initially, the Administration took the position that it wasn't going to talk to Iacocca. The new Administration wasn't going to have anything to do with this thing. It was awkward, because the loan guarantee board still existed. The loans hadn't all been repaid and so forth, and you couldn't have a meeting? I don't remember how all this worked out, but the loan guarantee board finally agreed to meet with Iacocca. Iacocca presented his demands, and the Treasury and everybody said "no." And there was no great argument about it in the Administration and the Federal Reserve. The warrants were not going to be given back. And I think that was the last meeting that I had with them.

MR. SMALL. So your big successes in life have been saying “no”—“no” to more money growth, “no” to this and that?

MR. VOLCKER. [Laughter] Absolutely.

MR. SMALL. In an earlier interview, we discussed the shift to the new operating procedures in October 1979 and conducting policy with those procedures over the next few years. When and why did you start moving away from those procedures?

MR. VOLCKER. I don't remember the timing, but when we stopped the emphasis on the money supply—and money supply growth kind of went wild—the question was how to express the short-term policy objective. We always had a formula that would translate what we said about the policy objective to what the probable impact would be on the federal funds rate. But we always avoided, or I tried to avoid, saying what's now become common practice—“The funds rate shall be X”—because we thought there was some advantage in letting the market have a little flexibility. That flexibility was important to allow the market to tell us something. If we kept net borrowed reserves—or nonborrowed reserves or free reserves or whatever we were using—as the operating target, the way the federal funds rate would respond or might change in its response over time was telling us something about the degree of ease or tightness in the market.

It may have all been an illusion; we didn't let it go very far: If the funds rate went up or down, we would adjust a little bit, but we didn't go out and say to the market that “The funds rate shall be 14 percent” or whatever it was. It makes me very uneasy to operate that way, of publicly announcing the target for the funds rate. You don't even need open market operations now. The Federal Reserve can make an announcement; they don't have to do anything else. The

market will say, “Okay, they want it at 4 percent, we’ll make it 4 percent.” The feeling was then that you lose something of some importance in that.

MR. SMALL. Perhaps what the Fed policymakers think they gain is that they look at the yield curve much more closely, and the options, and the futures, and they pull out what the market thinks the course of policy will be.

[David E.] “Dave” Lindsey wrote a piece on communications strategy that’s interesting in regard to these changes in operating procedures. He has the adjustment from nonborrowed reserves to borrowed reserves in the fall of 1982. In February 1983, “converting to restraint on reserve positions”; then, November 1983, introducing the “tilt.” Then, in early 1984, “introducing the degree of reserve pressure.” In 1985, “introducing the ranking of policy factors.”⁷⁰ So there’s obviously a lot of—

MR. VOLCKER. There was a lot of jockeying around that I don’t remember. I remember that we were always searching for the most sensible way to express the operating instructions to the Trading Desk and how much leeway to allow. I can’t enlighten you beyond that.

MS. FOX. And the reason for all the jockeying around was communications, is that right?

MR. VOLCKER. Well, mostly, it would involve communication to the market. But there was always a question of how much leeway the Desk should have. Right now the Desk has none, as far as I can see. The FOMC says the federal funds rate will be X, and the market will go there anyway. But when you deliberately allow a little flexibility, then there’s always an argument about whether the Desk has too much discretion in determining where to go. These

⁷⁰ David E. Lindsey was deputy director, Division of Monetary Affairs, Board of Governors of the Federal Reserve System. [For more on the changes in operating procedures, see] Lindsey (2003, pp. 69–71).

were all in an effort to reconcile the Committee's desires with appropriate constraint on the Desk.

MS. FOX. From the New York Reserve Bank side, having worked with the Board, did you bring some real predispositions about the Desk's role and what the FOMC ought to be doing?

MR. VOLCKER. Before I came here—I don't remember about Miller, but—Burns tried to micromanage the Trading Desk. Burns didn't get along with Al Hayes [president of the Federal Reserve Bank of New York], so Burns was trying to make sure that Hayes had no particular influence on the Desk, and that the Desk was reporting to him and not to Hayes. The staff of the Trading Desk were officers of the New York Reserve Bank, so they couldn't help but send reports to Hayes as well.

By the time I got to the New York Bank, Burns was still the Chairman, and the problem still existed. Alan Holmes was a longtime, highly effective manager of the Open Market Account. He managed both domestic and foreign operations. He had everybody's respect. He was a good bureaucrat in the best sense. He was intelligent, he had a good relationship to markets, and he was widely respected in the market. But he was driven crazy by Burns's heavy hand. I tried to relieve it some and was probably successful relative to Hayes, although not entirely successful. Axilrod had the direct job of sitting on Holmes and following Burns's instructions, and he was in an awkward position. When I came to Washington to be Chairman, Alan Holmes and I were good friends. So there were no personal antagonisms going on. But still, I must say, given who I am, I liked to keep a close watch, too.

MR. SMALL. Did you have the pre-call discussion every morning?

MR. VOLCKER. There was a pre-call discussion, but I don't think I ever participated in it. Axilrod was heavy handed from the point of view of the New York Desk. He wanted to make sure that they were not exceeding their authority. If there was a big problem, he came running down to talk to me about it. There may have been one exception, but I don't think I was ordinarily involved directly.

Air Traffic Controllers Strike

MR. SMALL. In the summer of 1981, you were leaning hard on inflation, President Reagan was relatively new in office, and there was the air traffic controllers' strike in which Reagan confronted the union. Did that psychologically reinforce what you were trying to do?

MR. VOLCKER. I think so. I don't know how much I understood that at the time, but I think that was very important. It was peculiar that the strike was not on wages. The fact that the union ignominiously lost and Reagan had been so tough had a very important impact on labor-management disputes from then on. It was a significant factor—which has persisted to this day—in weakening labor's bargaining position, which helped in smoothing out inflation. That viewpoint is not unique with me, but it doesn't get as much attention as I think it deserves. The combination of the recession, unemployment, and that backbone in the face of a strike that was considered unbeatable all had a big effect on weakening the bargaining position of labor unions.

The Hunt Brothers and the Silver Crisis

MR. SMALL. What about the Board's involvement in the silver crisis involving the Hunt brothers?

MR. VOLCKER. Jerry Corrigan wrote a long report about this at some point. The basic story was simple enough. There had been a big run-up in the prices of silver and gold. The price of silver went from \$5 to \$50 an ounce. One day, I was in a Board meeting. I got a call that I

needed to talk to so-and-so in the market. So I did, and the person on the other end said that I had to do something: I had to close the silver market, because Bache [Bache Halsey Stuart Shields] was going to go broke. Bache was probably then the second biggest brokerage firm. It was never considered a first-rank firm, but it was big. Bache had been the principal banker for Bunker Hunt; Bache had all these loans secured by silver. As the price of silver went down, the margins were lost, and Bache was selling silver. If the silver price went down any further, Bache said, the loans wouldn't be covered, and it would go broke. It would have been a huge mess.

I consulted with the Treasury. I don't know where Miller was at that point; I don't remember talking to him at all. We discussed the matter with the Deputy Secretary of the Treasury. And I remember discussing it with the CFTC [Commodity Futures Trading Commission]; it presumably regulated this part of the market. I called the CFTC and asked for statistics and who knew about all these positions on silver. I was told that was all confidential information: "It's none of your business." [Laughter] This was a strong-headed chairman of the CFTC (James Stone); it was a peculiar organization at the time. They had a couple of really conservative guys on the board.

Anyway, after much discussion, we decided to do nothing. We weren't in charge of the silver market anyway. And Treasury decided not to do anything. So we didn't ask for the market to be closed that day or the next day. The price stabilized for the next day, and Bache managed to get out of the rest of their position on that day. But many others, including Merrill Lynch, were exposed. And the First National Bank of Chicago was quite exposed, so it was still a problem. I don't remember what we did right then, but the silver price did go down some more. Although some institutions were close to being in trouble, they escaped.

In September, we had said banks shouldn't make speculative loans. At this point, the market was still very fragile. A Texas banker had the idea of consolidating all this lending to the Hunts and stabilizing it; the banks would all get together to deal with Bunker Hunt in a coordinated way. He asked me, "What do you think of this?" They had come to us because we had this federal prohibition against banks engaging in speculative lending, and they said, "This is a speculative loan against silver." We said, "Well, yes, that could be said." [Laughter]

But we all blessed their proposed arrangement to consolidate the outstanding loans, which seemed to make sense, if we got Bunker Hunt sufficiently locked in. So the deal was made, and they consolidated all these loans and took the collateral—everything that Bunker Hunt had—under their control, with our oversight. All of Bunker Hunt's available assets were put in collateral in some Delaware bank, including his horses. And that was going to remain that way until the loan was repaid. It took a long time for the loan to be repaid, so Bunker Hunt's been out of business ever since then, I think.

MR. SMALL. There's a story of you in Florida, Boca Raton.

MR. VOLCKER. That was a little while later. I get another call from the head of Engelhard [Engelhard Minerals and Chemical Corporation], a big gold and silver dealer. I had met him a few times and vaguely knew him. Now Engelhard was going to go bankrupt because they had this big silver position that was secured by a lease on Beaufort Sea oil development rights. What are we going to do about it? They have a lot of bank loans that they couldn't repay. I don't remember all the details. But anyhow, it happened to coincide with a meeting of the Reserve City bankers in Boca Raton, where I was going to go anyway and make a speech. The lending banks had an informal meeting in the evening to discuss this. There must have been 15 bankers and creditors around the room trying to agree on what terms and conditions they

would [need to] continue helping with the problem with Engelhard. And they couldn't come to any decision. Finally, I left and went to my room to go to bed. I thought that would help them make a decision, but then I got called back to the meeting. I put a pair of pants on, but I went down there wearing my pajama top.

Anyhow, some tentative decision was made. There was a commodity speculative firm that felt that Beaufort Sea was a good speculation. So they took the Beaufort Sea thing in return for paying off the loans. I don't remember the details. That was worked out overnight. The firm later combined with Salomon, and, later, the Beaufort Sea rights turned out to be worth nothing. Maybe now they would be [worth something] again, but at that time, I think they just wrote it off—\$500 million—which was a lot of money in those days.

The joke was that Bunker Hunt came to the hotel. I don't know why. He was at the desk at the Boca Raton hotel late at night where I stayed. The guy in front of him at the desk wanted to pay a tip or something, and he says, "Anybody got any silver?" meaning small coins. But Bunker Hunt said, "Yes, I have some." [Laughter] I don't know if it is a true story.

I think that the business with Bunker Hunt was when I first really came into contact with Bill Taylor, because Bill was the guy who said that if the Fed was going to get a lot of collateral, then go get it, get on top of it.⁷¹ Bill Taylor was the guy you wanted to be running it. He could take care of it, that's for sure.

Penn Central, Lockheed, Franklin National, and Other Crises

MS. FOX. Was that one of the first times that the Fed got involved in organizing one of these kinds of rescues?

⁷¹ William "Bill" Taylor was an officer in the Division of Banking and Supervision and Regulation at the Board of Governors [of the Federal Reserve System]. Later, he became the director of that division.

MR. VOLCKER. I don't know what they did earlier in the Great Depression. I still don't know if they used this emergency authority of section 13(3) of the Federal Reserve Act in the Depression. The only book about this was written by Howard [H.] Hackley, who was the general counsel at the Board for years.⁷² I think he said there were some loans for a total amount of \$1,500,000, that order of magnitude, but he didn't say what they were for. I still don't know what it was all about.

MS. FOX. But nothing in the Burns era?

MR. VOLCKER. There was Penn Central where nothing was done.

MR. SMALL. Lockheed in 1971.

MR. VOLCKER. For Lockheed, there was nothing done by the Federal Reserve. Those were all under discussion, but I don't remember there being a real question of using Federal Reserve money. It must have been raised, but I think it was dismissed. With Penn Central, the U.S. government was going to lend up until the last minute, using the Defense Production Act of 1950 as authority on the theory that Penn Central transported defense goods. The Defense Department did not take great pleasure in this theory.

MR. SMALL. Two banking issues early on were Franklin National and Herrstadt.

MR. VOLCKER. Franklin National was a big deal, but I was in the Treasury then. It was a national bank, so the OCC [Office of the Comptroller of the Currency] was involved. I don't know how much the Board was involved in that. The Federal Reserve Bank of New York was certainly heavily involved. I was on the sidelines. I was a little bit involved, but the OCC was under the other undersecretary of the Treasury. The guy who ran Franklin was accused of being a sharp, possibly illegal, operator.

⁷² See Hackley (1973).

MR. SMALL. This explosion of federal debt, globalization, and the sloshing of money—is that what’s behind a lot of these crises? And has there been mission creep where, in every crisis, the Fed keeps getting pulled in farther and farther?

MR. VOLCKER. There’s a danger of that. It seems that way. The one that Burns got very interested in—I don’t know if the Federal Reserve ever did anything in the end—was a mini crisis with REITs [Real Estate Investment Trusts] in the middle of the 1970s. I remember Chase being involved. There were bank losses at that time, and I remember Burns being all upset about it. But I don’t remember if the Federal Reserve ever did any direct lending.

MS. FOX. The REITs went down the tube, and there were some big bank losses.

MR. VOLCKER. I don’t remember, maybe they eased policy. It was about 1975, as I remember.

Regarding Penn Central, Burns did a lot of easing of money at the time, but not direct lending to Penn Central. He was concerned about the adverse effect on the commercial paper market. Sounds familiar.

MR. SMALL. And then there’s your hometown of New York City defaulting.

MR. VOLCKER. Yes, New York City was pretty straightforward. I don’t think Burns wanted to lend to them.

MS. FOX. The story is that, somehow, President Ford got pressured in Europe about it and then put more pressure on people.

MR. VOLCKER. Well, I don’t remember. I was just brand new in the Federal Reserve Bank of New York then. Certainly initially, the Treasury certainly did not want to do anything. I thought Burns was on that side, but I’m not sure. In any event, the Congress did authorize lending under tougher conditions.

October 23, 2008 (Fifth Day of Interview)

MS. FOX. Today is October 23, 2008. I am Lynn Fox. I am joined by my [Board] colleagues, David H. Small [of the FOMC Secretariat in the Division of Monetary Affairs] and Cynthia R. Carter [of the Division of Banking Supervision and Regulation], in Paul A. Volcker's office on Fifth Avenue in New York City.

NY Fed Presidency and Banking Regulation

MS. FOX. Mr. Chairman, I want you to move out of the crises of 2008 and back to the placid days of 1975. You were then the new president of the Federal Reserve Bank of New York. What were the big issues?

MR. VOLCKER. Well, then we still had Regulation Q.⁷³ Citibank had broken out of some of these regulations, with Walter Wriston in the forefront, when the negotiable CD [certificate of deposit] was invented. I guess Regulation Q wasn't applied to them. At least later it wasn't.⁷⁴ So that gave banks a certain flexibility they hadn't had before.

It's very hard to put myself back 40 years, but Citibank had always had a big international operation, particularly in Latin America. It was way ahead of the other banks in international operations. Bank of America made a big effort internationally in those years. Chase was international, but behind.

MS. FOX. Was the bread-and-butter for those banks plain-vanilla commercial loans?

MR. VOLCKER. Yes. It was commercial loans. I guess it was still true that they would only get heavily involved in other commercial lending areas during recessions. When they

⁷³ Regulation Q imposed ceilings on the interest rates that member banks could pay on time and savings deposits and prohibited member banks from paying interest on demand deposits.

⁷⁴ Regulation Q deposit-rate ceilings on large negotiable certificates of deposits (CDs) were suspended for short-term CDs in 1970 and for all CDs in 1973. For more information on this topic, see Melton (1977).

didn't get enough business loans to use all their funds, they would do real estate loans and that kind of stuff.

MS. FOX. At the time, consumers were served by the banks and by the thrifts?

MR. VOLCKER. Thrifts were much smaller. They couldn't branch widely. The big issue for New York banks was expanding. There were restrictions, but they could branch within New York State.

MS. FOX. I remember the stories about the New York City banks deciding to move to upstate New York, trying to push out the local banks, and having their hat handed to them. Is that an overstatement?

MR. VOLCKER. I don't know. They might have had their hat handed to them, but not their head. When I was there, Chase bought the biggest bank in Rochester: Lincoln First Bank. It was quite a successful bank at the time. But Chase tried hard to expand upstate.

I guess Eurodollars were a big deal then. They'd become a big deal, and there was a lot of intellectual concern about how a central bank should deal with Eurodollars, which were outside its direct control—was that adding to problems and so forth. Eurodollars started sooner than that, but had gotten to be quite substantial probably by that time.

You haven't asked me, but one of my early stories is when I went to the NY Federal Reserve Bank as president. The Bank had the practice of meeting with the big New York City banks, I think just once a year, for lunch. This was a big deal. I thought, all right, we're meeting with Citibank. I wanted to prepare for the meeting and asked for their examination reports. And my staff said, "Examination reports? We don't talk about those things at this lunch." Nevertheless, I wanted to see the examination report, because we might as well have a little substance at this lunch. They brought it to me, and I couldn't understand it. It didn't look right.

I knew roughly how big Citibank was: “What’s going on here?” The numbers didn’t reconcile with what I knew was the size of the Citibank holding company. I discovered the examination report was just for their domestic operations, and that’s all the NY Fed examiners looked at. At this point, Citibank was at least 30 or 40 percent international. “What are we doing, only looking at the domestic operations?” The examiners responded, “Well, we don’t look at the overseas offices.”

“What about their capital position?” It was pretty low. Then I discovered, I think from years earlier, the NY Fed regulators had some formula for capital that was a reasonable formula. When I looked at it, no banks were reaching the formula amounts. And the regulators weren’t insisting upon it. If I remember correctly, Citibank’s actual capital was about 50 percent of what the formula said it should have had. I said, “Well, why don’t we enforce it?” The response was, “Well, we don’t enforce it for anybody. We don’t really discuss it.”

It was the first time one of these banks came in. I don’t know how long I’d been there. So we changed that. We decided to have this little lunch and a supervisory discussion—in general terms, we didn’t press details. But I raised questions about their capital, their lending policy, and all the rest when earlier they had just been talking “How is business? What do you see in lending trends? How is the economy doing?”

MS. FOX. If you had wanted to enforce something against a bank, what would have been the mechanism?

MR. VOLCKER. Well, you could do a cease-and-desist order. When I was at the New York Reserve Bank, Citibank again was in some kind of a scandal. It was a huge scandal of manipulating their foreign exchange position in Europe. They did a lot of trading. The accusation by the European countries was that Citibank was moving its foreign exchange around

to evade taxation, and there was a whistleblower. This became a public thing. So I felt we had to have an investigation.

We didn't supervise Citibank, because it was a national bank. But we did supervise the holding company. So I insisted upon an investigation. I don't remember where the Comptroller of the Currency was at all. I made the first of my many mistakes in this area of investigations: I let them have their own law firm make this investigation. I since discovered, you don't get a very aggressive investigation having the law firm investigate its own bank client. [Laughter] And the law firm said, "Oh it's confusing," and they didn't come to much of a conclusion. In the end, we didn't do anything, as I remember. But some of the foreign countries actually got some tax payments paid. But this was typical, frankly—Citicorp going to the edge.

Later, when I was at the Board—this is a great incident—we still had Regulation Q, and the Comptroller was the regulator of Citibank. John G. Heimann [Comptroller of the Currency, July 1977 to May 1981] was a friend of mine. He came to me and said, "Look, Citibank has violated Regulation Q." The Federal Reserve was the enforcer for Regulation Q. Citi was giving away pots and pans, radios, or television sets for deposits. The Federal Reserve had a limit on what they were supposed to cost, and Citi was clearly exceeding the limit.

The Comptroller told them to stop. They said, "Okay, we'll stop." Not very long afterwards, the OCC got complaints that Citi had begun again. This time when the Comptroller investigated, he found out that Citibank was cooking its books. It was not reflecting the actual cost in its books. This was a federal offense. It's against the law. It's a criminal offense, I guess, to manipulate the books or lie in the books. So the Comptroller went to the U.S. Attorney's office and said, "Look, Citi's violating the law." The U.S. Attorney said, "We are not interested in petty crime. We're not going to go chasing Citi for giving away pots and pans."

So the Comptroller came to me and said, “What should I do? What do you want to do about this?” We did have the authority by that time. We’d never used it, but there was a law passed saying the Federal Reserve could assess a financial penalty, not just a cease-and-desist order, for violations of regulations. This is, again, when I was young and naïve. We’d never had a case where we’d penalized anybody.

I guess Bill Taylor or somebody recommended a \$1 million penalty, and this came to the Board. We’d never had any penalty at all. Nobody was anticipating anything like a \$1 million penalty. We sat there and discussed it. We finally arrived at a great idea that maybe \$1 million is a little overdoing it. So we decided on \$500,000 or whatever it was. My feeling was that was enough of a penalty, because it would get adverse publicity in the press, and Citi would be embarrassed. To my disappointment, the only place I ever saw it in the press was on something like page 13 of the *American Banker* in two little tiny paragraphs. So they got away easy. But that kind of incident is reflective of the lack of aggression, I think.

MS. FOX. The stories you just told are interesting, and they have this contrast. At some level, the regulators don’t examine. They don’t ask about the foreign operations. The regulators have a nice luncheon about what’s going on in the world, and that suffices. At the same time, they’re pouring in great detail over what kind of offerings are made from the bank lobby to make sure that no one was evading the stringent interest rate regulations of Regulation Q. At the time, did that seem odd to you?

MR. VOLCKER. When I say this, it sounds very critical. Actually, the guy who ran supervision in the Federal Reserve Bank of New York was very experienced. He’d been around from the Depression, I suppose. I think they were examining the loan portfolio. They weren’t examining the loan portfolio in London, but they were examining the loan portfolio in New

York, which was certainly the heart of the lending business. So they were probably pretty much on top of that. They thought that was the central issue, which in a way it was. But they certainly weren't paying much attention to the capital. But that was not just Citibank, that was the whole industry. Citibank led the parade.

MS. FOX. You said that was back when you were young and naïve. What was your developing thinking about the regulator's job?

MR. VOLCKER. By instinct, I thought banking regulation was important. I certainly thought capital was important, which had not loomed very large. The issue that really arose—maybe not in 1975, but in 1977 and 1978—was the foreign lending. That was the big bubble at that time. Arthur Burns was hot on that. He was right about it. Most people, including Citibank most of all, were saying, “No, it's all fine. We're recycling all this money. We're doing good. Countries don't go bankrupt,” and so forth. Arthur Burns was inveighing against it in speeches a number of times. It was symptomatic of the times.

The Comptroller had a regulation—a single-borrower limit. You couldn't lend more than 10 percent of your capital to any single obligor. Mexico came up against that probably in 1976 or so, sometime in there. Again, John Heimann was the Comptroller, and when I was President of the New York Reserve Bank, he came and said, “What should we do about this?” Cutting off Mexico all of a sudden from foreign borrowing would have been a big incident. We really didn't want to do that. The State Department said they didn't want us to do it. So we finally decided that—technically, it was Heimann who did it—he would interpret the single-borrower limit [as] not taking all the Mexican government agencies as a single obligor, but different arms of the Mexican government would be separate obligors, which got out from under the limit—for a while, anyway.

That decision was symptomatic of the regulatory concern coming up against the general concern that we didn't want to disrupt Latin America, because they couldn't borrow any money when this process was going on. Later—we're getting into Burns's concern—Arthur appointed me to develop a policy about how to deal with this lending to Latin America and elsewhere.

MS. FOX. You were at New York at that point?

MR. VOLCKER. Yes, I was at the Federal Reserve Bank of New York. Of course, most of the big banks in New York were doing this foreign lending, and banks all over the country were doing it. We sat around and thought about it and made up what I called a "sophisticated matrix." It wasn't all that sophisticated. Basically, we had some system for judging the creditworthiness of particular countries. We knew what the banks were lending relative to their capital. Under this matrix, if you had a weak country and you were heavily exposed to that particular country, you were supposed to stop making new loans to that country. If you had a strong country and you weren't so exposed to it, you could go ahead. If it was in the middle, you got a yellow light. You got a green light, a yellow light, or a red light. And the examiners were instructed to apply this.

I don't think it had any impact on anybody. It's one of the times in my life I discovered something: It's too bad, but when you're in a bureaucracy or in a regulatory system, people understand it when you say "no" or when you say "yes," but if you say "use your judgment by these criteria," it doesn't work very well. It's awkward. It took me a long while to learn that lesson.

MS. FOX. The Latin American debt crisis and the near failures were a really big part of what you did during those years.

MR. VOLCKER. We had the New York crisis.

MS. FOX. Yes, but before that, in 1972, do you remember Bank of the Commonwealth in Detroit?

MR. VOLCKER. I remember it was a complicated problem, and some other banks were involved. If I remember correctly, Merlyn Trued, a former assistant secretary of the Treasury, was out there in Detroit. I remember it was a tricky problem and involved several banks. All the Detroit banks were in trouble, and they were the worst.

MS. FOX. The bank limped along under these different owners with FDIC money in it. Irvine H. Sprague, FDIC chairman from February 1979 to May 1981, said the lesson that he learned was, if the government puts money in an institution, it doesn't solve the problem, because it makes the institution so suspect.

MR. VOLCKER. I remember Commonwealth was on the edge. Maybe they finally went under when I was at New York.

MS. FOX. The reason for bringing that up and talking about some of these other cases is to understand your thinking about problem banks.

MR. VOLCKER. When I was in the New York Fed, I don't remember having any important failing banks on my watch. I may have had some in trouble, but I don't think we had any really failing banks.

MR. SMALL. Regarding the financial landscape, you mentioned large CDs. In the 1950s or 1960s, banks took in whatever deposits they had and then found customers for loans. In later decades, it gets flipped around. They first go and find any loan they can make, and then they just tell the funding manager—

MR. VOLCKER. That's right. You are correct.

MR. SMALL. So you saw the beginning of that when you were at the New York Fed?

MR. VOLCKER. First of all, you had a negotiable CD, but you also had the Eurodollar market that was getting big. There was no Regulation Q in Europe, so U.S. banks could raise funds in Europe and bring them back here. But we still had Regulation Q, so U.S. banks would get in trouble when interest rates rose, even in the late 1970s. The negotiable CDs did affect their ability to raise deposits to some extent. And there was always pressure on the Federal Reserve to raise the deposit rate ceiling, so Regulation Q was getting liberalized.

MS. FOX. Were you a spokesperson for getting rid of Regulation Q?

MR. VOLCKER. Well, I was never on the leading edge of liberalization. But you had to get rid of it. To answer your question, I was in favor of some deregulation. Phasing out Regulation Q was part of the Monetary Control Act of 1980. Then government had to get rid of Regulation Q. I was the chairman of the committee that was supposed to manage this in the Carter Administration. When the Republicans came in and Regan was the Secretary of the Treasury, he wanted to chair that committee. So I gracefully said, "If you're so eager, you can chair the committee." At the same time—I don't think it was required by law—we were going to be open and have the meetings in public, which changes everything.

I was trying to maneuver this to gradually work away from Regulation Q limits over the course of a year or two or three. And the new Administration came in and said, "We're in favor of freedom. We're going to get rid of it right away." I would have controlled it, because I would have convinced the others that it was a little dangerous going too fast, that we should do this gently. But then the Republican Secretary of the Treasury said, "We want to get rid of it in the interest of freedom and openness." And the new head of the FDIC said, "In the interest of freedom and openness, we want to get rid of this." I was a little on the defensive, saying, "Let's go slowly." We ended up going much faster than I would have gone.

MS. FOX. That committee was called DIDC, wasn't it?

MR. VOLCKER. The Depository Institutions Deregulation Committee. By that time, there was so much pressure. You had to get rid of Regulation Q. You certainly had to liberalize it.

MS. FOX. That bill [Depository Institutions Deregulation and Monetary Control Act of 1980] had another provision that said all of the regulatory agencies had to review their regulations and simplify them. It had a five-year sunset. It was a regulatory simplification act.

MR. VOLCKER. I have no memory of that.

MS. FOX. The inclusion of that sunset provision suggests that there must have been some calls for change, some opposition to regulation.

MR. VOLCKER. There was certainly opposition to regulation. I guess, in 1980, before the Republicans came in, there was this truth-in-lending simplification reform. I was in favor of that. I may have proposed that. That was one of the first things I did when I went to the Board. I said, "Let's simplify truth in lending," which was a story, too—that was another lesson for me.

MS. FOX. What made you interested in truth and lending?

MR. VOLCKER. Well, the banks were always complaining about how complicated it was. When I was in New York, it was a steady source of irritation. Anybody looking at it would say, "Why do we need more than 100 pages to regulate consumer interest payments? Let's simplify it." What happened was, I said, "Let's make the regulation less than 100 pages," or whatever I said.

The Board staff came back with a draft, and we put it out for comment. All the comments we got required more detail: "Tell us what to do in this specific kind of incident. We have something that doesn't pay interest for six months and then it jumps up. How precisely

should we calculate that?” So this great simplification ended up not much simplification. And it was the lawyers representing the banks that came in.

Investment Banks

MR. SMALL. When you were at the New York Fed, how important were the investment banks?

MR. VOLCKER. The investment banks were nothing like what they were before they all capsized.

MR. SMALL. They weren't a source of worry or financial instability?

MR. VOLCKER. In those days, if investment banks had a trading operation that amounted to anything, it was new. They were only introducing trading operations in the late 1970s and early 1980s. They were underwriters and merger and acquisition people, and they were relatively small. They were prestigious, but they were not big, important financial intermediaries at that point.

MR. SMALL. Were they partnerships, mainly, back then?

MR. VOLCKER. Yes. They were all partnerships. That kept them on the straight and narrow.

MR. SMALL. But then they switched.

MR. VOLCKER. Well, it was a policy over time. I don't think the big ones switched until—I think Goldman was the last one. But they were only five or six years ago, maybe eight years ago now.

MR. SMALL. So being partnerships, did that make them more conservative?

MR. VOLCKER. Oh, yes, without question. They only became corporations—that was the big argument among some of them—when they began taking on a lot of risks. And, of

course, it became very profitable. This was a way of both limiting their personal risk and getting a huge payoff for the insiders.

I guess there are no partnerships left. I forget when the last one may have still been a partnership. In the early 1970s, a place like Morgan Stanley probably had only 300 or 400 employees.

Too Big to Fail

MR. SMALL. I recently read a quotation that was attributed to George Shultz. He was asked about how to deal with the problem of “too big to fail.” Apparently, he said, “Well, if they’re too big to fail, make them smaller.” Maybe being partnerships kept investment banks small for a while.

MR. VOLCKER. It did. They were not considered systemically important, in terms of a loss at that time. I know that Adam Smith said something about regulation. Did I tell you this?

MR. SMALL. No, but you have been quoted in the papers.

MR. VOLCKER. Yes, well, somebody sent me a few pages from *The Wealth of Nations*. It said that banks are always getting into trouble: They print money and take deposits, they’re always overexpanding, and they go bankrupt. It is bad for other people. But I don’t know what to do about it, because I don’t want to regulate them too much. So he finally concluded that—this is Adam Smith—the thing to do is, keep them small. He says keep them small, and then, if they fail, they’re not upsetting the whole financial system.

Financial Crises

MR. SMALL. For a financial regulator, one area of being large would be deposits or the loan portfolio. But what about all this internal plumbing and trading? That’s where a lot of systemic risk comes in. Should regulation have moved into that?

MR. VOLCKER. I think, ex post, yes. But in those days, that stuff was really straightforward. You didn't have complicated derivatives. There were some futures in the foreign exchange market, but nothing systematically serious. They didn't have those interconnections. The interconnections you had were with other banks.

One of the things we worried about in Continental Illinois, for instance, was all this correspondent banking, where the smaller banks kept deposits with the big banks. Continental was a big correspondent bank. That was a big part of Chase Manhattan's business even, which was one of the biggest banks in the country. For Continental Illinois, it was a substantial part of its business model. Those relationships don't exist much anymore.

MS. FOX. So the systemic risk in the late 1970s and early 1980s was through the banks?

MR. VOLCKER. Well, that was one. But the other was, you just wanted to prevent a run by the public.

MS. FOX. You mentioned First Pennsylvania. I'll tell you what I learned about it from reading Irvine Sprague's 1986 book, *Bailout*.⁷⁵

MR. VOLCKER. It was very favorable as I remember it. I read it.

MS. FOX. Oh, yes, he's favorable to you. But it was an interesting read about this regulatory process that you all had to go through and what you had to learn.

MR. VOLCKER. I remember reading the book a long time ago. But Irv Sprague—somewhat like [Edwin] “Ed” Gray—was a congressional assistant back in the days when they had lots of assistants.⁷⁶ It was not unusual for a guy like that to be put in to the head of the FDIC, which was an extremely quiet agency.

⁷⁵ See Sprague (1986).

⁷⁶ Edwin Gray was chairman of the Federal Home Loan Bank Board from May 1983 to June 1987.

Irv Sprague had limited prior experience, and he was a modest man, but he was an honest man. And he got into this problem. He relied a lot on the Federal Reserve to assist him and to work the way through it, which was fine. But he knew his limitations.

MS. FOX. Well, in the spring of 1980, First Pennsylvania was a \$9 billion bank, which made it the 23rd largest in the United States, back when banks were small.

MR. VOLCKER. Now it's one quarter's loss.

MS. FOX. Yes, exactly right. The CEO was a guy named John Bunting.

MR. VOLCKER. He had been in the Federal Reserve. He was very aggressive. He was very conscious of his appearance, his dress, and his status in the Philadelphia community. He decided that he was an economist, and he just knew how to run a bank: "Why were these banks so stodgy? I'm going to go out and put this bank on the firmament." And he got in trouble.

MS. FOX. I think the way he achieved the growth was buying loans and buying Treasury securities. Do you remember?

MR. VOLCKER. I don't remember. I remember he was very aggressive.

MS. FOX. Yes. He got to be a big banker. And then the bank got in trouble. And the OCC was the regulator. And it made Bunting resign. Do you remember that?

MR. VOLCKER. Yes. It was an interesting question. Why was I so involved?

MS. FOX. Well, because you and your colleagues were worried, apparently, about the failure of that bank having ripple effects.

MR. VOLCKER. Yes. No question about that.

MS. FOX. In 1980, rates went up, and First Pennsylvania had a securities portfolio that went underwater. Fred Schultz [Vice Chairman of the Board of Governors] called Sprague, saying, "You've got to do something to save that bank, because if it failed, it would touch so

many institutions that there would be a big crisis.” The bank was borrowing heavily at the discount window.

MR. VOLCKER. That was our legal concern—so we got involved in that.

MS. FOX. And apparently the Fed said, until the FDIC figured out what to do, you’d keep lending to the bank. This is a policy issue later on: The bank is in trouble, the bank goes to the Fed’s discount window, the Fed lends, and, in the process of doing so, takes as collateral all the good stuff that’s in the bank.

MR. VOLCKER. Right, exactly. Well, I don’t remember that arising with First Pennsylvania. It easily could have. When Bill Isaac came to the FDIC, we had bigger banking problems.⁷⁷ He used to gripe: “I’m the real lender of last resort. You take all the good collateral. I end up holding the bag.” And there’s some truth to that. It’s an issue today.

I want to say one thing about First Pennsylvania before I forget. I don’t remember the details, but it got worked out satisfactorily in the end somehow. Citibank was very helpful. I guess they were a big correspondent of First Pennsylvania. One of the senior people in Citibank worked very hard to save that bank. I think Citibank put some capital in there. They got some other banks to put some capital in.

MS. FOX. In the end, it was \$325 million from the FDIC and \$175 million from a bank consortium, accounting for the \$500 million put into the bank. It would make sense that it was Citi.

MR. VOLCKER. I’m sure Citibank got that consortium together.

MS. FOX. It also had nothing to do with credit quality. It was a short-term mismatch on rates.

⁷⁷ William M. Issac was chairman of the FDIC from August 1981 to October 1985.

MR. VOLCKER. I guess they had speculated in long-term Treasuries. He bought long-term Treasuries, and they went way underwater, yes.

MS. FOX. Part of the deal, when they got the \$500 million, was that they would immediately sell those Treasuries and book the losses to start cleaning themselves up.

MR. VOLCKER. I don't remember that.

MS. FOX. Another interesting piece of it, I thought, given where we are today especially, is that it was the first time the FDIC decided to take irrevocable warrants.

MR. VOLCKER. I don't remember.

MS. FOX. The idea that all the regulators had come to was that you needed to make sure that shareholders took a hit. And you needed to get rid of the management. You're nodding.

MR. VOLCKER. Yes. I'm sure it was reasonable. I'm sure that's what we wanted to do. And Bunting was a particular problem as a former Federal Reserve person anyway. You had to get rid of him. He was distressed, because he had an image in Philadelphia.

MS. FOX. It was an unusual first-time story, using partly bank money, partly FDIC money, taking the warrants.

MR. VOLCKER. I didn't realize that. But it's interesting.

MS. FOX. Irv Sprague decided he wanted a shareholder vote on the package. And when it came to the vote, they only had one choice: Either the bank is gone and everything's gone, or they accept this deal with the warrants and so on. He wanted a shareholder vote, because he was worried about lawsuits. He tells in the book that you kept calling him up and saying, "Just do it. Don't wait for the shareholder vote. Just do it." Do you remember any of that?

MR. VOLCKER. [Laughter] I remember working closely with him, but I don't remember those details. Did he wait for the shareholders' vote?

MS. FOX. Yes, he did. They had the vote. And then he did a funny thing. He got somebody at Treasury to deal with the fiscal people and got a check for \$325 million and hand-carried it to Pennsylvania.

MR. VOLCKER. He did?

MS. FOX. Yes.

MR. VOLCKER. Like they won a golf tournament.

MS. FOX. Yes. The FDIC was sued over the warrants but won. So taking the shareholder vote was not a terrible thing.

MR. VOLCKER. They lost the shareholders' vote?

MS. FOX. No, they won the shareholders' vote. And then, later, some unhappy shareholders sued the FDIC, saying that the warrants were a "taking."

MR. VOLCKER. Even with the shareholder vote.

MS. FOX. Yes. So it was sensible that Sprague did that. But the point was that you all were worried about the spillover effects. Chuck Partee at that point was doing a lot of the work on this.

MR. VOLCKER. He was the Governor at that point who, I guess, was assigned the regulatory stuff. I think he had been overseeing the regulatory issues for the Board before I was the Chairman. I don't remember. But it was logical that he would.

MS. FOX. Yes. And John E. "Jack" Ryan, who was then—

MR. VOLCKER. He was head of supervision. So he was involved, yes.

MS. FOX. In that era, were you beginning to feel concerned about the whole banking infrastructure and the possibility of contagion?

MR. VOLCKER. Yes. I would have been concerned for two reasons. We're now talking about 1980—we had the Latin American debts mounting up, and we had interest rates skyrocketing. So, yes, without question, this was on my mind.

MS. FOX. And the mutual savings banks—the New York institutions started going down the tubes at the same time.

MR. VOLCKER. Well, all the savings and loans were in trouble. Net worth certificates—I guess they were really non-net-worth certificates. [Richard T.] Pratt came in as chairman of the Federal Home Loan Bank Board in 1981. He was a very aggressive fellow. He was a take-charge guy. And he was independent minded, but that was all right. He certainly wanted to smooth over the crisis as best he could. And he initiated, I'm sure, all this forbearance business, which was quite formal, but I don't remember the details.

So the savings and loans had certain capital requirements. They were low, but they had some. If they'd marked all the stuff to market, they would have been lost. And there was no explicit requirement that they mark to market. They were under whatever the regulator said. And the regulator certainly said, "You don't have to mark-to-market all these mortgages," which I thought was the appropriate policy. Otherwise, they all would have gone bust.

MS. FOX. So that was regulatory forbearance.

MR. VOLCKER. Yes, absolutely. This is criticized now, why we prolonged all those things. But the theory was, when interest rates came down again—I had great hopes they would come down again—the thrift institutions would be okay, which was true for most of them. It wasn't true for all of them, but it was true for most of them. And when the real savings and loan crisis came, the first one had been papered over, in effect—I think more or less successfully. It

was broadly successful. The real crisis came after passage of the Garn–St. Germain Act.⁷⁸ They all went and said, “See, all these mortgages are killing us, we’ve got to invest in other things.” So the Congress gave them permission to invest in other things. And they promptly went out and got in trouble.

MS. FOX. This whole idea about forbearance—you can put them all out of their pain, but the effects of that—

MR. VOLCKER. Put them out of their pain; the FSLIC [Federal Savings and Loan Insurance Corporation] would have run out of money in a hurry. This industry was the backbone, in those days, of the whole mortgage industry. Rates went way up, but you didn’t have the defaults. Thrifts did require down payments and stuff, so that wasn’t the problem. It was an interest rate problem. They were carrying fixed-rate mortgages, and there was no good market for mortgages anyway. If they’d been forced to mark their mortgages to market, it would have been like now. It would have spiraled downwards.

MS. FOX. And it would have gone to the taxpayers, ultimately.

MR. VOLCKER. Ultimately, somebody would have had to pick it up.

MS. FOX. Yes. There was a joint lending program created in 1981. I don’t know much about it except that Pratt and you worked out a deal whereby thrifts could get long-term credit from the Fed under certain circumstances. Do you recall that at all?

MR. VOLCKER. No. But it doesn’t sound impossible. I don’t have any specific memory of it. I’m sure I wanted to support what he wanted to do. We were in league at that point. No question about that.

⁷⁸ The Garn–St. Germain Depository Institutions Act of 1982 deregulated some activities of savings and loans.

MS. FOX. The point of it was, you were using all the tools in the kit to address the savings and loan problem. Give them access to liquidity, give them forbearance.

MR. VOLCKER. What did we do? Give them liquidity through the Federal Home Loan Banks? I've got a feeling we may have done all of that on paper but never did anything. I'm not sure. I think maybe nobody applied. I don't mean it was a phony thing. But I have a feeling that, if it was activated, it didn't turn out to be a big deal. But it served the purpose of providing some reassurance.

MS. FOX. Looking back on it, you were focused on managing inflation, and interest rates were going up. Were you in any way forecasting problems like the savings and loan problems?

MR. VOLCKER. Well, interest rates were higher than I ever thought they were going to get. I certainly knew they were going to go up for a while. But they stayed up longer than I thought. I think we just thought, "This is a casualty of the war. That ought to be manageable." We did manage it.

Mark-to-Market Accounting

MS. FOX. Assume that some years from now we are going to have another problem with high interest rates. Having gone through the experience, would you advocate that some things be put into place initially?

MR. VOLCKER. This gets into this whole question of mark-to-market accounting, among other things. Partly growing out of this experience, I do not think mark-to-market accounting—to make a sweeping statement, and it'd have to be a lot more nuanced—is appropriate for regulated depository institutions, because this problem will recur. If they mark everything to market, the only way they can defend themselves is by doing what they were

doing, selling all their loans to somebody else, or if they do keep any loans, have flexible interest rate loans. And it seems to me that, in the end, you end up with a weakened banking system, which we did. The banking system all got pushed out into the market, and a lot of people say that's great, that's the way it should go: It's open, competitive, flexible. It's also unregulated, and it hasn't done very well, I think we now demonstrate, and now people are running back toward the banks—very interesting.

If I were king, one of the things I would do is have a big review of mark-to-market accounting. This is not a new position on my part, obviously. I found myself as chairman of the International Accounting Standards Committee that appoints the people on the board that makes this ruling.⁷⁹ The accountants were all gung ho for mark-to-market accounting. Here I am chairing this oversight board. And I ask, "What are you doing?" And they say, "Shut up, we're making these technical decisions—that's what the bylaws say, that's what your charter says." Now I'm no longer the chairman. But the international board, interestingly enough, just made a decision to relax mark-to-market accounting a bit under all this pressure. So it's an area that's going to take some thinking.

MS. FOX. I think the Congress has now jumped into that fray.

MR. VOLCKER. The Congress was going to put something more forceful in the recent bill than it actually did. The Congress just put in the bill that, I think, in three months or so, the Treasury ought to report the status of mark-to-market accounting and what Treasury wants to do about it. In one version, that bill required the SEC to practically get rid of mark-to-market accounting. I forget just how it was phrased, but the Congress softened the language into

⁷⁹ Mr. Volcker served as chairman of the board of trustees of the International Accounting Standards Committee from 2000 to 2005.

requiring the SEC to give the Congress a report. It was not totally by coincidence that, after that, the international people responded. The domestic people have not responded yet.

But the international people, under very heavy pressure in Europe—I don't know whether you want to go into this detail, but I know a little bit about it. They have these three parts of the accounting rule for a bank. There's a trading position. You mark it to market, and nobody questions that. If you promise to hold it forever, you don't have to mark it to market. They have this intermediate position that says, if you might sell it, you have to mark it to market, but you don't have to run it through the income statement. U.S. law says you have to follow that rule except in rare circumstances. As I understand it, the SEC said a rare circumstance has never arisen, and it never will arise, in effect. The international, which copied the United States, didn't have that clause—just said you have to do it. Once you do it, once you classify an asset, you have to keep it there forever. They changed that to formally conform with the escape clause we have in the United States and said you can change it in rare instances, and this is a rare instance. [Laughter]

MS. FOX. I remember mark-to-market debates probably later in the 1980s. But back in the 1970s—

MR. VOLCKER. Oh, no, this has always been a source of friction between the SEC and the Federal Reserve. The SEC always wanted to go toward mark-to-market, and the Federal Reserve always said, "No, that's disruptive. We don't want to do it."

MS. FOX. If you're going to hold loans and securities and you're not going to sell them, then why should your accounting act as though you're selling them?

MR. VOLCKER. And it's just an ordinary commercial loan. If you literally marked it to market, by the nature of a commercial loan with a customer, you made that loan because you

know the customer, and you probably have other relations with the customer. That's important in making a loan. A person who doesn't have those relationships and hasn't had a close relationship in looking at the credit isn't going to pay the same thing for the loan, or isn't likely to pay the same thing for the loan, that you did.

So if you really had to test it in the market, as soon as you made the loan, you'd have to mark it to a discount, which doesn't seem to make sense. Now, I don't think they require loans to be valued on the books under the strict mark-to-market ruling. But the accountants have all wanted to go further in the interest of transparency and investor protection. And that's their great rallying cry now. I think that will be slowed down. But it's a big issue.

E. Gerald "Jerry" Corrigan

MS. FOX. Moving on—what was Jerry Corrigan doing in those years when you were at the New York Fed?

MR. VOLCKER. When I went to the New York Fed, he was the Secretary of the Board, which was a position I guess, traditionally, they'd use for young comers. He had been in the economics department before I got there. Somehow he stood out, and they made him Secretary of the Board. He was very helpful during the transition. He was not fighting the transition as some people were.

MR. SMALL. The transition from Al Hayes, as president of the New York Fed, to you?

MR. VOLCKER. Yes. I realized Jerry was on top of things and was very intelligent, so I used him. I put him in several different places to broaden his experience. He ran the operations of the Bank at some point, or at least a big part of it. The New York Reserve Bank had been subpar in operations, and I took pride in improvements in efficiency. Jerry was head of personnel. That was an important position at the Reserve Bank. I think he had some operational

responsibility. He never went back in research. I don't think that he ever went on the Open Market Desk.

Management Philosophy and Issues

MS. FOX. What you said makes me want to ask about your management philosophy. You said that you thought he seemed to be good, and you assigned him different jobs to broaden his experience. How did you think about what your role as a developer of leaders and people ought to be?

MR. VOLCKER. Well, the Federal Reserve, I'd say, is not characterized by aggressive administrators, by and large. They tend to be analytic types and economists, lawyers or something. The Federal Reserve Bank of New York, in particular, would often man the operations side with staff economists or lawyers. To be sure, operations had special difficulties in New York that I would hear about endlessly. But operations had not been very efficiently run. If I had nothing else to do at New York, I thought I'd change that.

MS. FOX. You just got bored?

MR. VOLCKER. No. We were trying pretty hard, with some success, to bring up the operational side. We still lagged most of the other Reserve Banks in most of the measures, but instead of there being 11 Banks more or less in a group, and New York being down at the bottom, we at least got the New York Fed within sight of some of the others in the System. I just thought it was part of the public responsibility to run an efficient operation.

MS. FOX. Who was the first vice president?

MR. VOLCKER. When I went there, it was [Richard A.] "Dick" Debs. He's a very good friend of mine now. Dick had ambitions to be president. He's a very capable person, so I'm sure he was somewhat disappointed. He stayed for a while. Then he got a chance to go to

Morgan Stanley and be a partner—I want to say a year or so later. Then [Thomas M.] “Tom” Timlen, who was a lawyer, became the first vice president. He may well have been head lawyer at some point. It was not an atypical pattern for a lawyer to be put in as first vice president. Tom was interested in operations. He did well.

In my last annual report, I made a thing about talking about the operations of the Reserve Bank, because I wanted a record that I’d done a good job as an operational guy. I have some memory of writing the annual report to show how operations had improved. I know the personnel count went way down. The Bank had never fired anybody before I got there.

MS. FOX. Never?

MR. VOLCKER. Well, that’s what they said. I don’t know. I was told, “We have never fired anybody.” I didn’t fire very many. I tiptoed around it. I think we did ask some people to leave. But it wasn’t a mass layoff.

MR. SMALL. When you went from there to the Board, what was the amount of, or lack of, culture shock, in terms of operations at the Board?

MR. VOLCKER. At the Board, I decided we were going to reduce expenditures. I got Lyle Gramley, a good loyal lieutenant, to administer this. We were thinking about reducing expenditures by 7 percent. We asked the different departments to categorize where they thought the cuts could be made. Predictably, the research department said, “Let’s not do the Industrial Production Index anymore,” because nobody liked to do it. There was no chance that we were not going to do the Industrial Production Index. I don’t think we fired anyone. I don’t know if it was reduced expenditures or reduced headcount, but 7 percent is what sticks in my mind. I think we did it over a couple years. Bureaucracies like to grow, and I wanted to have a little counterpressure.

Banking Liberalization

MS. FOX. Do you remember the events regarding the liberalization of what banks could do?

MR. VOLCKER. Importantly, there was the liberalizing of the underwriting of securities, and the banks began using that authority. In my mind, the underwriting provision of the law was quite clear in its intent, but it was written in a way to leave a lot of judgment about what underwriting a bank could do in an affiliate. It was pretty clear that you couldn't do it in a bank itself. But there was this language that was imprinted on everybody's mind.

MS. FOX. The law used "principally engaged."

MR. VOLCKER. "Principally engaged." The banks finally set up some of these bank holding companies, and a couple of them had a commercial paper business or another business. And, arguably, you could say that if only 10 percent of the subsidiary's business was underwriting, it conformed to the law, in that the subsidiary was not "principally engaged" in underwriting securities.

Where I put my foot down—I was leaving anyway—the law at that point had a peculiarity. It said the banks could always underwrite municipal securities in the bank. But the way the law was written, they couldn't do it in a subsidiary, which sounded a little ridiculous—that they could do it in the bank but, they couldn't do it in the subsidiary. So the Federal Reserve, with my support, said, "That's ridiculous, so we'll let them underwrite municipal securities in a subsidiary because the Congress must have meant that, even though it's not in the law." It doesn't make sense that they can't do in a subsidiary what they can do in the bank. So we let them underwrite municipal securities in a subsidiary substantially free of the "principally engaged" restriction.

Then, just before I was leaving, there were two cases before the Board. One said the subsidiary was doing some business other than underwriting, and they wanted to do 10 percent or something of underwriting. I said, “Okay.” Then this other bank said they were doing municipal bond underwriting in a subsidiary, so their corporate underwriting would not make the subsidiary “principally engaged” in corporate underwriting because they are doing so much municipal underwriting. I said, “My God, now you’re piggybacking on it. You can’t take advantage of our generosity. You do municipal bond underwriting to piggyback something the law obviously was concerned about.” I lost ingloriously on that, but I simply wanted to make a point as I said my goodbye.

MS. FOX. You voted against it, but the others voted for that.

MR. VOLCKER. Yes, it was right when I was leaving. I didn’t care whether I lost. I was just having fun making a point.

MS. FOX. From what you’ve told us so far today, you were willing and anxious to push for regulatory relief—if that’s what you want to call it—regulatory forbearance, changes in procedures and practices.

MR. VOLCKER. If I didn’t think that disrupted what the basic idea was of supervising the activities that the banks were undertaking.

MS. FOX. On the other hand, you were shy about securities activities.

MR. VOLCKER. Yes, I think it’s fair to say I was not on the leading edge of full-blown investment banking—not to the extreme we have it now. But the Treasury certainly was eager to liberalize. There was always the question of allowing banks to engage in real estate and real estate brokerage, insurance underwriting, insurance brokerage, and underwriting debt and underwriting equity—all these things were up in the air.

At one point, after a lot of negotiations, we agreed with the Treasury on a bill. I don't remember the details of that. It certainly would have allowed bond underwriting. I forget whether it would have allowed equity underwriting. I can't remember the limitations. It probably allowed insurance brokerage but not insurance underwriting. It probably prohibited real estate development, which I was a bug on. Anyway, the bill was built on consensus. What I don't remember is what happened to it. It got overtaken by events somehow. I don't think we ever sent the bill up to the Congress, but I don't remember why. Something happened, I think, that made it inauspicious. But it wasn't a bad bill. I don't think it probably ever became a bill. It was an agreement between us and the Treasury. Yes, with Regan.

MS. FOX. Did you change your views dramatically on anything?

MR. VOLCKER. What I rationalized to myself, anyway, is that technology had changed to the point that it was hard to know what was and what was not underwriting. And you began packaging loans and stuff. I didn't want to see it all move out of the banking system. So this was a way to recognize technology and keep it within the broad ambit of supervision. I can't say that I was out there leading the political parade, jumping up and down, saying this is the most wonderful thing in the world. But I thought, given all the pressure that existed, psychologically and otherwise, it made sense.

Much later, the Federal Reserve greatly liberalized what these banks could do in underwriting. We started out with 10 percent, and then the "principally engaged" criteria got up to 25 percent. Then the Federal Reserve approved insurance; I was not very happy with that, just as a legal matter.

MS. CARTER. There was this period when banks like Citicorp were really pushing the envelope. They would come to the Fed and say, “Will you approve this? Will you approve that?” They were just chipping away at the prohibitions.

MR. VOLCKER. You’re absolutely right. Chipping, chipping, chipping, but they never got around to the law until 1999. Gramm-Leach-Bliley legalized what the Federal Reserve was already approving. I guess the Federal Reserve said, “We’ll approve it, but if they don’t put it in the law before long, we’ll have to take it back.”

MS. FOX. In later years, the Fed got pushed into approving things because of regulatory competition.

MR. VOLCKER. No question about it. I’m sure that the Federal Reserve was being pushed. The Federal Reserve was the most conservative regulator, because the others were pushing harder. Phil Gramm, Jim Leach, and Tom Bliley got in there with legislation at the last minute. But it was a big fight to contain the legislation at that time to something that seemed sensible. Leach was the protector there. There were two issues. One was whether to let the financial institutions get into commerce. The Congress pretty much held that line. The second was whether the Federal Reserve would be the overall supervisor. Leach was a strong guy on both of those points. They were crucial.

Regulatory Agencies

MS. FOX. In your tenure, was it quite that combative between the regulatory agencies?

MR. VOLCKER. At times there was a lot of rivalry and a lot of pushing, and other times there wasn’t.

MS. FOX. Who do you remember being pushy?

MR. VOLCKER. Well, I go back to my time at the Treasury. The Comptroller of the Currency is in the Treasury. For some reason, the Kennedy Administration appointed [James J.] “Jim” Saxon, a very aggressive guy, as Comptroller of the Currency [1961–66]. He didn’t want to pay any attention to the Treasury, much less the Federal Reserve. He was very anti-Federal Reserve. The Treasury then was filled with ex-Federal Reserve people in crucial positions who were very sympathetic to the Federal Reserve. So they were not interested in Jim Saxon running all over the Federal Reserve. He wanted to expand bank powers. He was just making very aggressive interpretations of law—using some language in the law such as “and such other powers as appropriate” or something. He was taking a very aggressive view, and the Treasury kept trying to pull him back.

Saxon was from Chicago. He was, I think, a vice president at First National Bank of Chicago. At one point, the Treasury really had trouble controlling him. At one point, Treasury told me—a junior guy—that I was in charge of relations with the Comptroller. Saxon thought I was a little ant on the wall. He didn’t appreciate being told that he was supposed to report to me if he was going to make a new regulation or something. Treasury tried to corral him and say, “You can’t make a speech without us reviewing it. You cannot testify, you must not make a proposal to the Congress without getting our approval.” I think he finally had to conform to that.

MS. FOX. The OCC’s independence from Treasury was a big issue later in the 1980s.

MR. VOLCKER. I don’t doubt it. But I haven’t told you the great story of reforming the regulatory agencies?

MR. SMALL. The Bush task force—Vice President Bush?

MR. VOLCKER. Yes.

MS. FOX. You talked about that: a big effort that went to naught.

MR. VOLCKER. Yes, I thought I told you.

MS. FOX. Bill Isaac was the FDIC chairman from 1981 to 1985, and then [L. William] “Bill” Seidman was chair from 1985 to 1991.

MR. VOLCKER. Seidman was there when I was there. We used to meet regularly with the OCC.

MS. FOX. Do you remember John G. Heimann and C. Todd Conover as Comptrollers?

MR. VOLCKER. John Heimann is a good friend of mine. Conover was in between there.

MR. SMALL. Heimann was the OCC head from 1977 to 1981, then Conover from 1981 to 1985, and then Robert L. Clarke from 1985 to 1992.

MR. VOLCKER. Conover was a young guy from California. You wanted to talk about Penn Square. Well, Conover is Penn Square, which was an OCC-regulated bank. He wanted to be independent and all the rest, but he was pretty young and not very experienced. [William M.] Isaac was the head of the FDIC.

MS. FOX. Isaac was the head from 1981 to 1985. Sprague was on the board of the FDIC from 1969 to 1972, and later he was chairman from 1979 to 1981, remaining on the board through 1985.

MR. VOLCKER. Okay, yes, I guess that’s right. Sprague was my ally with the FDIC, and Comptroller Conover was on the board of the FDIC.⁸⁰

Penn Square and Continental

MS. FOX. Right. Sprague said that the FDIC board found out about the extent of the problems at Penn Square one day when, after a board meeting, Conover, relatively new on the

⁸⁰ As Comptroller of the Currency, Conover was an ex officio member of the FDIC board.

job, asked if Sprague would stay and talk about a problem they were having. Sprague said they learned about Penn Square's problem only "as the bank was on the way to the mortician."⁸¹

Conover got the pleasure of coming over to see you.

MR. VOLCKER. Conover came over and talked to me on, like, a Thursday afternoon or something. He said, "We're going to close up Penn Square tomorrow." I said, "You are not going to close up Penn Square. I never heard of the bank. I want to look at this before we make that great decision." And so he didn't. We hadn't closed an insured bank and paid off depositors for 20 years or more. It probably hadn't been done. And if it was done, it was some very small bank. I said, "Let's look into this and see what happens. You're not going to do this without telling the Secretary of the Treasury. He ought to be advised and shouldn't wake up in the morning and find out that we had to close the bank." So Conover unhappily delayed. I think Isaac was basically in favor of closing all along. But I got the Secretary of the Treasury involved.

Meanwhile, we found out how many uninsured deposits they had and so forth, which wasn't very much. One of the little curiosities was that one of the uninsured depositors was the credit union of the Senate staff.

I don't know how much we knew then about all these loans that they had palmed off on Continental Illinois and others. I guess we knew something. But there was nothing we could do to protect Penn Square. They were bad loans. Anyhow, after consultation, we found that there weren't very many uninsured deposits, so we finally went ahead and closed it.⁸²

⁸¹ See Sprague (1986, p. 110).

⁸² "During the July 4th weekend in 1982, the Comptroller of the Currency closed the Penn Square Bank, N.A., in Oklahoma City, with deposits of \$470 million, and the FDIC set up a DINB [Deposit Insurance National Bank] to pay off insured depositors. Penn Square had been an aggressive lender principally to small oil and gas producers. It

MR. SMALL. So what, if any, stake did Continental have in the manner in which Penn Square was handled or liquidated? Was there a financial repercussion?

MR. VOLCKER. Well, there was eventually.

MS. FOX. There's some story about Roger E. Anderson, chairman and CEO of Continental, coming to say "Don't close the bank" or something.

MR. VOLCKER. Yes. I think you're raising some dim memory that we must have told Continental or asked questions about the loan thing.

MS. FOX. It foreshadowed, in a way, Long-Term Capital Management, because the regulators actually did bring together the bankers that had exposure and said, "Do you know how much exposure you have?" Because there's a story that Roger Anderson at Continental had no clue that they had \$1 billion tied up in loans that—

MR. VOLCKER. I don't know that we said we were going to close the bank. I said, "Look, this bank is in terrible shape, and you've got these loans. Are the loans any good?"

MR. SMALL. Here's a quote from Bill Isaac out of this book, *Secrets of the Temple*, by William Greider.

MR. VOLCKER. I never read that book. I couldn't bring myself to read it.

MR. SMALL. Isaac is being quoted about the time of dealing with Penn Square. Greider writes, "Continental came in, Chase came in and the others, all urging us to handle it in certain ways [Isaac said]. We explored with Continental Illinois and others a merger. They had all kinds of schemes that would keep Penn Square going under new ownership so we would not

had grown rapidly, relying heavily on purchased deposits and, to a much greater extent, on a program of participating the loans it originated to large regional and money center banks. As a result, when the bank failed it was servicing a loan volume almost five times the bank's liabilities. The loans were premised on extremely high oil and gas prices, and when the market weakened and production was curtailed, they went into default, and what collateral supported them had only limited value" (Federal Deposit Insurance Corporation, 1984, p. 97).

have to liquidate all those loans. Continental Illinois and the others were trying to give us all their lousy loans. From the FDIC viewpoint, that was a bad deal.”⁸³

MR. VOLCKER. Well, I don’t understand that business about giving the lousy loans. They may have said, “We’ll take over Penn Square, but we’ll leave some lousy loans with you.” I don’t know how we could make that merger, because I would have thought it was against the interstate banking law, which still existed at that point. I do have some vague memory that we talked with Continental anyway. I don’t remember the details. It sounds right that we talked to Continental, at least, and they weren’t willing to do what we wanted them to do. So, in the end, we decided to close it up.

MS. FOX. So it only took two years after that for Continental to really belly flop?

MR. VOLCKER. Yes. The beginning of the end—right.

MS. FOX. What are your first memories or earliest memories about how bad Continental was?

MR. VOLCKER. Well, I may have told you this story too. It goes back to the regulatory attitude. I was the new Chairman of the Federal Reserve. You go around visiting the different Federal Reserve Banks. I went to Chicago. I went to a board meeting at the Chicago Reserve Bank, I’m sure. I must have met with the major Chicago banks at the same time. I asked the head of Continental and a senior person at First Chicago to meet with me afterwards. I met and I said, “You people don’t have enough capital, and I think you ought to raise more capital.” They told me to go fishing.

MS. FOX. This is at the very beginning of your term as Chairman?

⁸³ See Greider (1987, p. 497).

MR. VOLCKER. Yes, probably 1979. One of the people telling me that was a guy named Miller. I forget his first name. But he was an old Federal Reserve Board employee. He had gone, I guess, to First Chicago. I guess he was vice chairman or something. I don't remember whether Roger Anderson was in that conversation. Probably. I told him that they needed to raise capital. Those banks were very aggressive in making loans.

Continental, in particular, had dreams of becoming the leading commercial loan maker in the United States from one office in Chicago. So they were dependent upon what amounted to borrowed funds. It was a very top-heavy bank, because their capital ratio was low. They didn't have a stable deposit base, and they were very aggressive lenders. But it was interesting. I didn't tell them, "I don't care what you think, you're going to raise the capital," because I didn't have the authority, and I was new. But I remember they just rebuffed me; now, later: "We wish we'd listened to you." [Laughter]

MS. FOX. You must have stayed on them, because I read that, at some point in there, the Fed denied a branching application. It was like another little warning shot.

MR. VOLCKER. Well, maybe I got sore at them.

MS. FOX. So then, what do you remember after that about Continental?

MR. VOLCKER. Well, I don't remember. I was fishing in Montana.

MS. FOX. In your book, you talk about the chairman of Continental Illinois visiting you in Jackson Hole in Wyoming.

MR. VOLCKER. Yes. I got this urgent call. He had to fly out to visit me. He went out there and told me they were in big trouble. It was probably a year before they failed. It would have been in August, because that's when I was fishing. I said that in my book?

MS. CARTER. Yes. You said it was a bad fishing day, too. But you were visited by the chairman of Continental Illinois “who flew out to tell me the bank was in so much trouble [that] it would need Federal Reserve support.”⁸⁴

MR. VOLCKER. I don’t remember what we did. They probably borrowed from us.

MS. CARTER. I think they were at the discount window.

MS. FOX. What made the market aware that they were in big trouble is that they sold their credit card operation in early 1984 or maybe late 1983, which was their big profitable operation. I think things bumped along in quiet until suddenly, in May, when that run started.

MR. VOLCKER. Yes. Well, they were under surveillance for sure. I don’t remember everything we did, whether they were borrowing from us continuously or what.

MR. SMALL. What I’ve got here says, “Federal Reserve provided credit for an extended period. FDIC ultimately injected capital. And it was later repaid.

MR. VOLCKER. Yes, we were doing something to help support them in the hopes that they were going to get better. But then they had the run—or whatever they had—that weekend. This had some resemblance to some things that were tried recently more aggressively.

I had to go to New York to get an honorary degree, actually. So it was convenient, and I asked the New York banks to come to see me and Isaac, and I said, “Something’s got to be done about Continental. It’s failing. Why don’t you get together and create a syndicate, like the First Pennsylvania thing? And the FDIC can help, and you can put something in there. And we’ll see if we can save this thing.” The Citibank representative said, “We’re going to help a competitor?” He said, “We have no interest in helping a competitor.” I think some of the other New York banks might have done it.

⁸⁴ Editor’s note: See Volcker and Gyohten (1992, p. 200).

MS. FOX. Did you lay it out for them—that if this bank went down the tubes, all of—

MR. VOLCKER. Oh, well, yes, we told them they got to do something. Something had to be done with this bank. I don't remember specifically, but I think we said the FDIC would put in some capital and we'd lend to them, but you have to put in capital and support them; we'll see if we can save them. And they turned me down. So they left. Bill Isaac and I talked about it. He was very reluctant to save the bank all by himself, so to speak, without us alongside, but he finally conceded something had to be done, and I went off and got my honorary degree.

MS. FOX. You left the meeting and went off to Columbia University?

MR. VOLCKER. Yes. And when I came back, Bill and the staff had a press release pretty much prepared that said we were going to protect all the deposits. I had not contemplated that being in the press release. But Isaac convinced me, I guess, that if we were going to recapitalize the thing and imply that the deposits were safe, why don't we just say we're going to guarantee all the deposits. So we did. And we said we'd provide all the liquidity and—

MS. FOX. FDIC put in—

MS. CARTER. There was a \$4.5 billion 30-day line of credit.

MR. VOLCKER. That was us, wasn't it?

MS. FOX. Before you went to New York, the FDIC got a bunch of banks together who put together a line of credit. That was some number of days before you went to New York. And it didn't do anything. The money kept flowing out of Continental.

MR. VOLCKER. Okay, I'd forgotten about that. That's when I went up and told them, "All right, you have this line of credit, that's not going to work. You got to put in capital."

MS. FOX. So let's just buy it somehow—yes?

MR. VOLCKER. Sounds familiar.

MS. CARTER. Yes, it was \$4.5 billion. The FDIC—

Current Financial Crisis

MS. FOX. Did you at that time, or any time since, envision where the discount window and all these lending programs could go, ultimately?

MR. VOLCKER. Today? No way. Easy question. Doesn't say they are wrong. You asked whether I envisioned it. I envisioned the Federal Reserve buying commercial paper and lending to investment banks and lending to insurance companies? Not a chance.

MS. FOX. But there are two things that you said: "I can see that none of us envisioned it, but once everything's outside of the bank, once technology is there, once you set the precedent of serving up federal money to keep something worse from happening—"

MR. VOLCKER. "From little sins, big catastrophes arise" or something. Yes, I understand how you get there. They got there rather suddenly, in a big way. It's amazing.

MR. SMALL. Did Chase, or whoever were the tried-and-true responsible banks, argue that you had to be sterner with these rogue banks or rotten apples, that they were mucking the system up for everybody?

MR. VOLCKER. I don't think this early. In the earlier era when it was more petty stuff, they didn't like this business of getting around every regulation. They just thought it was not appropriate behavior. But it was not the big systemic thing. Chase was—

MR. SMALL. They weren't taking the line that the Continentals are the type of banks we have got to get out of the system, because they're—

MR. VOLCKER. I don't know. I'm sure Continental was not loved, but I don't think anybody said they were doing stuff that was illegal or whatever. They may have been taking too many chances, but they were all within the bounds of commercial banking.

October 24, 2008 (Sixth Day of Interview)

MS. FOX. Today is October 24, 2008. I'm Lynn Fox. I'm here with my colleagues Cynthia Carter and David Small in the offices of Paul A. Volcker in New York City. This is the second session of a two-day interview [and the sixth day of the interview overall].

Breakdown of the Bretton Woods System in 1971 and the "Volcker Group"

MR. SMALL. What are your views on the breakdown of the Bretton Woods system in 1971, and what was the role of the so-called Volcker group in attempting to rebuild the international financial system?

MR. VOLCKER. Just before I became undersecretary of the Treasury for monetary affairs under President Richard M. Nixon, I was sitting in my future office watching the inaugural parade come down Pennsylvania Avenue—which you could do in those days—and a memorandum arrived on my desk. It was National Security Study Memorandum 7.⁸⁵ The essence of the memo was that I was appointed to head this group to coordinate international monetary policy. Other departments were represented, including the Federal Reserve.

The memo also stated that I would report to Henry Kissinger.⁸⁶ That was a little awkward, because I was undersecretary of the Treasury. I went running down to the Secretary of the Treasury and said, "You better do something about this, because you're Secretary of the Treasury."⁸⁷ You're supposed to be in charge of these kinds of things." But he was not very forceful. I don't think he ever did anything.

The group proceeded, but we did not report to Henry Kissinger. He had a guy, [C.] Fred Bergsten, in the group, but I continued to report to the Secretary of the Treasury. Anyway, the

⁸⁵ See Kissinger (1969, pp. 290–91).

⁸⁶ Assistant to the President for national security affairs.

⁸⁷ David M. Kennedy.

group did coordinate international monetary policy. There was a big discussion on what to do when Nixon first came in. I can barely recall it, but, Allan Meltzer, in writing his history of the Federal Reserve, ran across a long memorandum that I'd written several months into office about what we should do. Allan Meltzer and I are not close personally, but he was so complimentary about this memorandum that it bowled me over.⁸⁸

We eventually suspended the gold convertibility of the dollar and devalued and all that stuff, ending in floating the dollar. [John B.] Connally was then the Secretary of the Treasury. After suspending convertibility, his idea of negotiating was not to put forward any position. He waited to see what other people did, and he took his time because he wanted to keep pressure on for a big exchange rate change, which was appropriate. We had what turned out to be a stopgap: a Smithsonian meeting where the exchange rates were reset in December 1971. That disintegrated a year later. That's when we ended up floating for lack of anything else to do.

There was great pressure to reorganize the monetary system. That's when we formed the Committee of 20 to propose reorganization of the monetary system.⁸⁹ There's another Group of 20 now. The present Group of 20 is a descendant of one of the recommendations we made in the original C20, which was first called the Interim Committee.⁹⁰ We proposed, among other things, what is now pretty close to the current Group of 20 and the Development Committee.⁹¹ But on

⁸⁸ Editor's note: See Meltzer (2009b, pp. 736–38).

⁸⁹ "Board of Governors [of the IMF] adopts resolution establishing a Committee on Reform of the International Monetary System, known as the Committee of 20" (International Monetary Fund, 2006, entry under July 26, 1972). Also see Solomon (1982, p. 224).

⁹⁰ Officially known as the Interim Committee of the Boards of Governors on the International Monetary System, the Interim Committee "was established in October 1974 to advise the Board of Governors of the IMF on supervising the management and adaptation of the international monetary system as well as dealing with disturbances that might threaten the system" (World Bank Group and International Monetary Fund, 1997, entry under "The Interim Committee").

⁹¹ The G-20 (Group of 20) was formally established on September 26, 1999. The membership comprises the finance ministers and central bank governors of the G-7 countries, 12 other key countries, and the European Union, which is represented by the rotating Council Presidency and the European Central Bank.

the substance of what to do with the monetary system, we never reached agreement. When we were trying to reach agreement, the oil crisis came along and threw everything up in the air.

A key element in the plan that I was pushing, and therefore the United States was pushing, was the “reserve indicator” proposal.⁹² The proposal provided that if a country was accumulating reserves in an excessive amount—which had to have been determined—the country would come under pressure to take appropriate actions to reduce its surplus. Conversely, if a country was losing too many reserves, there was a formula for deciding how to respond.

The relevance of all this, since you asked the question, is that two nights ago I was addressing a group with some other people, and Marina Whitman was there. Marina Whitman was a member of the so-called Volcker group. She was on the Council of Economic Advisers (March 1972 to August 1973). Marina was a very prominent female economist who’d been in government. She said, “Mr. Volcker, do you remember that thing you proposed in 1973? Have you thought about its relevance today?” My response was, “Well, if we’re talking reserve indicators, China would have been forced to adjust long ago, and so would some others. So maybe we ought to resurrect it.” She’s the first person who has recalled this in many years.

George Shultz had become Secretary of the Treasury, and he wanted to present something positive at the World Bank meetings that year, which would have been 1973, I guess. So I had to develop this plan. And that’s what we proposed at the World Bank meetings. That’s when the so-called Committee of 20 was set up.

MS. FOX. What ultimately happened to the Volcker group?

The Development Committee, or The Joint Ministerial Committee of the Board of Governors of the Bank and Fund on the Transfers of Real Resources to Developing Countries, was established in October 1974 to advise the board of governors of the IMF and of the World Bank on critical development issues on the financial resources required to promote economic development in developing countries. See International Monetary Fund (2010).

⁹² See Council of Economic Advisers (1973, pp. 160–75).

MR. VOLCKER. I'm sure it continued after I left Treasury. It was a coordinating agency for international monetary policy. We used to meet regularly and discuss things. When we went off gold, that program was not specifically discussed in the Volcker group, as I remember, because too many people were involved. But the reform program certainly would have been discussed there. The Volcker group had a forerunner in the Johnson Administration. That's why it was created so early in the Nixon Administration. It may have been formalized, but I don't remember. The undersecretary of the Treasury at the time ran it. So I inherited some of it.

MR. SMALL. Was the Volcker group mainly focused on exchange rate developments and flexibility, or did it get into international banking and regulation?

MR. VOLCKER. I don't think we did regulatory stuff. As I recall it, we dealt with IMF, exchange rates, adjustment process, liquidity provision—that kind of stuff.

Capital Standards

MR. SMALL. When during your career did you first get deeply into the nuts and bolts of regulatory issues and capital standards?

MR. VOLCKER. Well, we discussed capital previously. I was preoccupied with capital standards from the beginning of my Fed chairmanship. We pushed within the United States, within the Federal Reserve, to get capital standards up. I'm not sure it was terribly successful. One of the blocking points was that American banks all complained that you would put them at a competitive disadvantage.

I was somewhat involved in banking regulation earlier, because the Comptroller of the Currency was in the Treasury, and I was supposed to keep track of the OCC head back in the early 1960s. I don't think we were very effective. As I recall, the major issue then was bank

powers. The Comptroller wanted to expand them all the time. The Federal Reserve was certainly more hesitant about that, and the Treasury itself was more hesitant.

MS. CARTER. In 1983, there was an agreement with the OCC, applicable only to the 17 multinational organizations, requiring [the ratio of] primary capital to total assets to be at least 5 percent. I don't know if that was a first.

MR. VOLCKER. Certainly, at that point, 5 percent was considered a big improvement over where it had been.

MS. FOX. In 1983, the debt crisis is going on. You've got all these bank failures. There's a new bank examination report. There's this capital agreement with the OCC. I believe that, in that period, all regulators agreed to an exchange of information. There was a lot of fixing of the plumbing, which inevitably happens after a tough time.

MR. VOLCKER. I don't remember those things specifically. I do remember that we were pushing for higher capital standards. I was pushing the Reserve Banks to increase their supervisory personnel. I also was trying to get them to reduce expenditures, and they were giving me a hard time: "You told us to reduce expenditures. Why are you telling us to increase supervisors?"

MS. CARTER. It certainly was in the headlines a lot about the Fed pushing for higher capital, more stringent capital rules. I'm looking at a 1983 article that says: "Federal Regulators Impose New Capital Rules on Banks."⁹³ You and [John E.] "Jack" Ryan are featured.⁹⁴

MR. VOLCKER. I didn't realize it was that prominent. We did run into the problem of how far up you could go when the Japanese banks are at 1 or 2 percent capital ratios and the

⁹³ Editor's note: See Ross (1983).

⁹⁴ John E. Ryan was director of the Division of Supervision and Regulation at the Board of Governors from 1977 to 1985.

European banks were squabbling. There was a group in Basel that assessed bank capital and supervisory stuff generally. As it started out, for years they were trying to simply get a consistent definition of capital so that bank regulators could compare different practices—knowing apples from oranges. That was difficult enough, and it was a long, bureaucratic process.

I must confess, it was mostly I who finally said at BIS [the Bank for International Settlements] meetings, “Let’s go beyond this and get international agreement on what the capital standard ought to be.” I can remember that. Then I had a meeting with Peter Cooke.⁹⁵ He said, “We can’t do that. We can’t even get an understanding on these more technical points. That’s way too ambitious.” Anyway, I got the Group of Ten central banks to agree that we ought to push in that direction. But there was a lot of resistance, and it was going very slowly. At that time, we were doing this overall leverage thing, 5 percent. Others were saying, “That’s too unsophisticated. We can’t agree with that.” The Europeans and the British were working toward the so-called risk-based capital. The British proposal wasn’t very sophisticated in terms of risk, but so-called risk-based capital standards were more favored in Europe.

So the really critical meeting was when—I don’t know whether this has ever come out—I was in Europe for some reason. I stopped to visit with the governor of the Bank of England on my way home. I remember we had a dinner at some facility of the Bank of England outside its head office.

We talked about this issue of capital standards. It was a breakthrough. I said, “If we go with your framework, will you work together? It’s a quid pro quo. You work with us to get the capital standards higher, and I’ll back your so-called risk-based formula.” He said, “Okay.” It

⁹⁵ W.P. Cooke was an associate director at the Bank of England and was a member of the Basel Committee on Banking Regulations and Supervisory Practices; he was chairman of that committee from 1977 to 1988.

was Robin Leigh-Pemberton. Leigh-Pemberton was an aristocrat, Constable of Kent or something, one of these ancient titles. Margaret Thatcher didn't support him strongly, but that's beside the point. He said, "Okay." Then the Europeans went off on their own and wanted to do it their way. I don't remember what the dispute was, but they were going slow. Then the British came along with us, and we negotiated an agreement, which was public. That put enormous pressure on Europe to join in. We also got the Japanese to agree in principle.

We announced the agreement in late 1986 or early 1987.⁹⁶ And we decided on that—not counting on the Europeans—knowing that they would probably have to come along, and they did. Then, after I left office, the so-called Basel Agreement (now Basel I), which was the same agreement, essentially, that we reached with the British, went into effect.

MS. CARTER. So the whole concept of risk-based capital—is that more of a European idea?

MR. VOLCKER. Well, it started out that way. I don't remember any particular debate about risk-based capital in the United States. The first Basel risk-based standard became distorted, and it was very simplified. Everybody now says, "It was much too simple. We have to reform it." It has taken 12 years to think of some agreed-upon way to reform the standard. Now that they have finally completed it, many people think it isn't very good and needs to be reviewed again.

MR. SMALL. I've always assumed that the reason banks resisted higher capital was simply because of the cost of capital. It didn't have anything to do with ownership control or diluting control by stockholders.

⁹⁶ In 1987, the agreement was formalized in conjunction with the Basel Committee on Banking Regulations and Supervisory Practices, other U.S. federal banking agencies, and supervisory authorities from the leading industrial countries.

MR. VOLCKER. More leverage. When we had the simple leverage ratio, it applied to everything. So it gave the banks a perverse incentive. This was always irritating; banks ceased holding government securities because they would have had to hold 5 percent capital against government securities just as they did against a loan. They said, “Why should we hold a low-yielding asset if you’re imposing this 5 percent capital requirement?” So I guess, in our proposal with the British, we went way in the other direction and stated that banks have to keep little or no capital against government securities. But anything you do that’s reasonably simple, banks can play games with. They said, “Why do we have to keep the same capital against General Motors as we do for some slipshod company?” And it was true. The answer was, “Well, you’re supposed to keep capital above requirements and not go so close to the margin.” This is ironic now that General Motors has just about gone bankrupt.

One of the interesting things—I think in the beginning, when the first Basel accord went into effect—was that there was a great banking crisis. So banks all wanted to go well above what the minimum capital requirement was. That was a big constructive difference. Thank goodness they did. That was a much healthier attitude than trying to play it right on the margin all the time.

Bank for International Settlements

MS. FOX. What was the Fed’s role at the Bank for International Settlements (BIS), and how did you participate?⁹⁷

MR. VOLCKER. As background, the United States was active in creating the BIS in the 1930s. The first head of the BIS was an American—this is the 1930s—but from the start, the

⁹⁷ The Bank for International Settlements, established in 1930, is an international organization of central banks based in Basel, Switzerland. Its primary purpose is to foster international monetary and financial cooperation and serve as a bank for central banks.

United States backed out from formal participation. Stock was allocated to all the founding members, which included the United States. But the U.S. government never took the stock—suspicious of international banking, or European control, or whatever. During World War II, the BIS became irrelevant. When it started again, there was a debate back and forth about whether the United States ought to participate.

Probably in the Roosa era at the NY Fed and the Treasury—I don't think before that—we began going to some meetings, particularly of the so-called G-10 governors and the subgroup of foreign exchange officials. Then that became more regular, but we weren't a member. The potential U.S. member, set out in the statute of the BIS, was the Federal Reserve Bank of New York. This was done before 1935. So it was the Federal Reserve Bank of New York that was supposed to have the stock.

When visitations began again, [Charles A.] “Charlie” Coombs, who was in charge of foreign exchange operations in New York, went regularly. He was with his international colleagues—all the foreign exchange people from the G-10 central banks. That was their monthly meeting. They all were eager to go to exchange views. I guess Al Hayes must have gone to the Group of Ten governors meetings—before my day. These meetings paralleled in membership the G-10 ministerial-level group that had been established earlier.⁹⁸ The U.S. participants went as nonmembers to the BIS. I don't remember whether Hayes went regularly. I think Chairman Martin rarely went. At that time, nobody in the United States wanted to be a member. And there was a technical problem.

MS. FOX. What were the reasons for not wanting to be a member?

⁹⁸ The Group of Ten consists of 11 countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States) that consult and cooperate on monetary and financial matters. The G-10 “refers to the group of countries that have agreed to participate in the General Arrangements to Borrow (GAB)” (International Monetary Fund, 2010).

MR. VOLCKER. I think it was still a political feeling that this was an unduly secretive and European-dominated organization. And there was a technical reason. Agencies of the United States who are members of an international organization had to report, in a sense, to the State Department. The finance officials were not interested in having the State Department get involved in this sensitive stuff. So that was a technical reason to avoid it.

Later, Chairman Burns, who wanted to establish himself as an international central banker, was very much in favor of joining. I was in Treasury then, and I was opposed. I didn't want the Federal Reserve joining, possibly challenging Treasury's primacy in international finance. George Shultz, who was the Secretary of the Treasury at that time, was wavering, but finally I convinced Shultz that he didn't want to permit that. Burns came very close to negotiating membership, but one of the hazards was whether it was going to be the Federal Reserve Bank of New York that was joining or the Federal Reserve Board represented by Arthur Burns. And Arthur Burns was certainly not interested in having Al Hayes as the U.S. and Fed representative going to Basel, so they were going to change the articles or something to meet that requirement. I don't remember what position Chairman Miller took one way or the other, but when I became Fed Chairman, I still wasn't particularly interested in joining.

MS. FOX. And had you ever gone from the New York Fed as president?

MR. VOLCKER. I must have, but I don't remember.

MS. FOX. If the New York Fed had been active, where in the New York Fed would it have been staffed? Is there an international division?

MR. VOLCKER. Yes, there was both a foreign research department at the NY Federal Reserve and a foreign operations department. Charlie Coombs, who ran this, was a very strong personality. He had a natural interest in the Federal Reserve joining the BIS, because the BIS

was a vehicle for the people in the various central banks' foreign exchange operations to get to know each other and build confidence in each other. And it was a vehicle necessary to coordinate operations—particularly interventions in foreign exchange markets. They knew each other and could discuss market conditions. It was important from that standpoint. But, from the U.S. end, it was dominated by Coombs. When Coombs left, about the time I became president of the Reserve Bank of New York, Alan [R.] Holmes—who then was in charge of foreign exchange operations as well as domestic operations—or one of his subordinates would go.

I have no recollection that I ever went to the G-10 governors meeting before becoming Fed Chairman. When I became Fed Chairman, I'd go when I thought it important, but I didn't have any interest in becoming a formal member, because I thought it just complicated life. If you were a member, you had to be on the BIS board of directors, and it had business operations. You would have had to take responsibility. And they occasionally did things that I didn't like anyway.

MS. FOX. Such as?

MR. VOLCKER. Well, they bought and sold gold. And there was sentiment to restore gold as part of the monetary system. Anyway, the membership idea was dropped during my tenure. But I would go twice a year, maybe. I would go more frequently if there was a crisis. And the Federal Reserve was regularly represented, mainly by Governor Henry Wallich.

MS. FOX. Did the Vice Chairman go then? Did you alternate?

MR. VOLCKER. Henry Wallich would have gone. Part of Henry Wallich's deal, de facto, at the Federal Reserve Board was that he would be the Governor responsible for international. He loved it, with his whole Germanic banking background and so forth. He would faithfully go every month, I'm sure. And to dislodge him from that position would have been a

terrible blow to Henry. So he always went. Somebody from the New York Federal Reserve went. And I would go once in a while.

I remember two things. During this debate about capital standards, I would go to push the Europeans fairly frequently. There was also a time in late 1985 and early 1986 that I was trying to push the Germans and others as much as I could to ease their monetary policies. BIS meetings were the forum for doing that.

That informal arrangement lasted through my tenure. Alan Greenspan, I guess, was interested in becoming a member. And it didn't take him very long to join. It didn't change anything very substantively, but I don't know how or whether they modified the articles of agreement or something.

MS. FOX. Maybe there had to be congressional approval.

MR. VOLCKER. That's another thing. I didn't want to go to the Congress either. I didn't want the Congress messing around with it. But I don't know. Now we're members, but I don't know that it has changed anything in substance.

MS. FOX. The group that worked on capital adequacy, was it the full BIS board?

MR. VOLCKER. It was delegated to a committee, which was called at that time the Committee on Banking Regulation or something.⁹⁹ They were basically the banking regulators from the central banks and other national regulatory agencies. That committee was expanded. The Federal Reserve Bank of New York, when I was there, fought to maintain Federal Reserve primacy in that area. But the Comptroller of the Currency said, "Look, I regulate banks. Why am I not represented?" And the FDIC said, "I regulate banks. Why am I not represented?"

⁹⁹ "The Basel Committee was established as the Committee on Banking Regulations and Supervisory Practices by the central-bank Governors of the Group of Ten countries at the end of 1974 in the aftermath of serious disturbances in international currency and banking markets (notably the failure of Bankhaus Herstatt in West Germany)" (Bank for International Settlements, 2009, under the heading "At a Glance").

MS. FOX. Today, the Comptroller goes.

MR. VOLCKER. I think it ended up with all three being involved.

MS. FOX. It was the New York Fed, the Board, and the Comptroller, I believe.

MR. VOLCKER. That's right. The Board wanted to be represented too.

MS. FOX. Having gone to BIS meetings, do you recall a time when having those relationships was important?

MR. VOLCKER. Establishing those relationships is very important. We illustrated it most clearly when I was Chairman during the Latin American debt crisis. The BIS was very important in providing some money, which was partly symbolic—more than symbolic, but it was not the heart of the money problem. That was the forum for getting cooperation and agreement by the central banks. In my mind, it was very useful—even essential. We didn't have to be members. We received all the benefits in policy discussion and formulation without any of the responsibility for the business and banking operations of the BIS.

Are Banks Special?

MS. FOX. A theoretical issue that was generated by Jerry Corrigan, and maybe you as well, was the topic: Are banks special? Can you tell us about that issue and the extent that Jerry Corrigan and you might have coordinated your thinking?

MR. VOLCKER. There was pressure during that period by some commercial business firms to own banks. It was reflected most clearly by Sears Roebuck. It went on a big political campaign. Sears Roebuck spent a lot of lobbying money. Congressmen were invited to visit the company headquarters in Chicago, and Sears representatives would explain how important it was to get in the banking business—the synergies and everything else.

MS. FOX. I remember “stocks and socks.”

MR. VOLCKER. Stocks and socks, that's right. Anyway, I was Sears's big enemy. I thought there were all kinds of conflicts of interest. One big argument was: If Sears Roebuck owned a local bank in some town, how are the other local retailers going to compete? That was part of the argument. There were broader arguments as well.

MS. FOX. In other words, that a Sears-owned bank could put a squeeze on everybody and not lend to the other retailers.

MR. VOLCKER. Yes, that was one argument. The other argument was that the banking system was regulated, and how do you regulate Sears Roebuck? You get into all kinds of borderline questions. This became pretty intense, but we succeeded in fending it off. Jerry Corrigan had his name on the thing: "Are Banks Special?"¹⁰⁰ I certainly argued it, but his essay was particularly prominent.

We were in league on that subject, as you are correctly surmising. In general, the Federal Reserve was against commingling commerce and banking. I don't know that all the Board members felt as strongly as I did, but I don't think there was any big dispute within the Federal Reserve that I can remember, if there was any. But the lobbying effort on the other side was pretty strong. It was always questionable whether the Congress would concede to that pressure. They did around the edges—the problems always came around the edges, whether some states would permit it in the guise of industrial banks and whether a federal override would be possible. I don't remember all the details. But there were some compromises made, although the broad principle has been upheld.

MS. FOX. There was the famous "nonbank bank," which was developed to get around it: the bank that wasn't really a bank because it didn't accept deposits.

¹⁰⁰ Editor's note: See Corrigan (1983).

MR. VOLCKER. That's right. We tried to get the Senate Banking Committee to draft legislation outlawing nonbank banks, I guess, but the committee wouldn't do it, because the nonbank bank was a vehicle for getting around the separation of commerce and banking.¹⁰¹ The argument over commerce and banking really came to a head long after I left with the Gramm-Leach-Bliley Act. Maintaining the distinction was one of the big fights there. Jim Leach was on that side. Some compromises were made, but he basically held that line.

MS. CARTER. Did you stay in touch with Jim Leach?

MR. VOLCKER. I did during that period, yes. He was very important, because he was chairman of the House Banking Committee and he managed to maintain that line of separation between commerce and banking. The two issues for the Federal Reserve were that one and, of course, who was the overall supervisor. Technically, the Federal Reserve won them both. Whether the Fed's authorities were implemented as forcefully as they should have been is another thing. It was a pretty narrow vote. I'm sure Phil Gramm was on the other side of this issue.

Efforts to Change the Regulatory Structure of Bank Supervision

MS. FOX. Even in the era of the Bush task force, there was some thought of giving the Fed oversight over the large banks. Were you planning ahead for supervisory adjustments like that?

MR. VOLCKER. Well, just as a matter of instinct and psychology, in my mind, the Federal Reserve is always the primary supervisor whatever the law says. [Laughter] The Fed has the broadest responsibility and ought to have some influence on the other agencies and some

¹⁰¹ Commercial firms could own so-called nonbank banks without becoming bank holding companies subject to Federal Reserve oversight.

influence on them all or whatever. At the time of the Bush task force—we discussed this, didn't we?—the offer on the table at the last minute was to give the Fed authority over what I guess was expressed as “all internationally relevant banks,” which would have meant about 50 banks, I thought, at the time. Give the Fed everything—the holding company, the bank, everything— for those organizations. As part of the deal to give the Fed oversight of the largest banks, the changes would have rescinded the Federal Reserve's oversight of small banks.

Rightly or wrongly, I didn't like that. What were the Federal Reserve Banks going to do? You were going to raise a problem with the whole structure of the Federal Reserve. I didn't want to give up the political advantages of the Federal Reserve having contact with all the small banks, so we didn't go that way.

MS. FOX. Let me ask about the politics of the Fed having oversight relationships with the small banks. The way that was translated in the political arena was that the small independent banks would always support the Fed's position in the Congress. But there's also this political aspect to the Federal Reserve System, where these Reserve Bank directors around the country have some loyalty to the Fed.

MR. VOLCKER. It's all part of the same thing.

MS. FOX. Do you recall times in which Reserve Bank presidents and directors were used specifically, that you had conversations with them or made plans with them?

MR. VOLCKER. I don't recall any organized effort to marshal those directors as a lobbying group in the Congress. I suspect there might have been times, organization-wide, when there was some legislative issue where a Reserve Bank president would suggest to a director, “If you know Congressman so-and-so, why don't you call him on this issue.” But I don't recall any organized effort.

MS. FOX. Obviously, you knew the directors of the New York Reserve Bank and stayed in touch with them, but were there any directors outside of New York that you recall relying on?

MR. VOLCKER. Not regularly. I expected the Reserve Bank presidents to do that. But there were directors at some Reserve Banks that, for whatever reason, I became more familiar with and closer to—because of their particular expertise and background, personal rapport, or whatever. You'd get to know them particularly when you were picking a new president of a Reserve Bank or something. There was a director in Kansas City who ran Sprint later: Paul Henson. I talked to him a lot. There was more than one director in Texas that I relied on, and a number of others.

MS. FOX. What was the background of the guy in Texas?

MR. VOLCKER. The one who I would have wanted to be Vice Chairman? Bob [Robert D.] Rogers. He ran a mini steel plant that I went through once. Mini steel plants have become important steel producers these days. He was one of the leaders, but it was not his principal business. He was a son of a well-known Texan who was in some business, but he took a close interest in the Fed and was very knowledgeable. The other guy in Texas who was particularly valuable was Gerry Hines. He's a prominent real estate developer these days. He was prominent at that time, but more in Texas. He built the big shopping mall, the Galleria, in Houston.

MS. FOX. He was on the Dallas board?

MR. VOLCKER. Yes, and he became the chairman.

MS. FOX. Former Fed Vice Chairman Fred Schultz was very pleased about creating an opportunity for the chairmen of Reserve Bank boards of directors to come to Washington during his tenure on the Board.

MR. VOLCKER. That was important. I didn't realize that started with him.

MS. CARTER. The directors program.

MR. VOLCKER. They still do it now, don't they?

MS. FOX. Yes, they do.

MR. VOLCKER. That was one occasion for getting the chairmen and vice chairmen together. There were a few directors that, for some reason, went out of their way to get to know me or I went out of the way to get to know them. I went fishing with them or something. I remember Gerry Hines very clearly. There was a great boom in Texas in the early 1980s after the oil crisis, and he was telling me that he was being flooded with money with practically no interest, very favorable terms. He had to turn it all down because he thought they were in the middle of a bubble that was going to burst. Everybody was pouring money into Texas.

MR. SMALL. What were some instances in which the boards of directors or the members of the boards were influential, important in conveying information, or provided insights about bubbles or regulatory structure?

MR. VOLCKER. Well, Gerry Hines was one specific example. More generally, they did have some influence. They were a crosscheck on thinking, in some sense: Whether the Reserve Banks were pressing for discount rate changes or not. I suppose in 9 out of 10 cases, when a Reserve Bank board was proposing a discount rate change, it was because the Reserve Bank president wanted it. But the president in turn had to be influenced by the general tenor of his board, or he wouldn't have pressed for a change unless his board at least acquiesced.

Then, of course, there's the accusation that you have a conflict of interest, because some [of] them are bankers. So, is this structure a plus or a minus? It's mostly a plus. Without that structure around the country, you wonder about protecting the independence of the Federal Reserve. That's what the underlying issue was.

Texas Bank Failures

MS. FOX. In connection with the Texas bank failures and all the efforts to merge the banks as they failed, was Bill Taylor key to that process?

MR. VOLCKER. Well, the mergers started in a more benign way. I remember that the chairmen of Chemical and Texas Commerce Bank came in to see me very proudly to announce Chemical Bank would buy Texas Commerce, which was one of the big Texas banks. We knew that Texas Commerce was in trouble. I guess we didn't realize how much. I'm sure Chemical did not realize how much trouble Texas Commerce was in.

The irony of the story was that the banks that were most resistant to interstate banking were the Texas banks, because they were all booming in the early 1980s. And many could not stand the idea of other banks coming into Texas. If you were going to have any interstate banking, it was, in their view, going to be regional, with the Texas banks dominant. Then we skipped over that. I don't remember when—

MS. FOX. Actually, we skipped the topic of the regional compacts.

MR. VOLCKER. I testified before the Congress in support of repeal of the restrictions on interstate banking, but the actual repeal happened a few years after I left the Federal Reserve.

MS. FOX. There had been a bill to allow regional compacts for five years or six years before moving to full interstate banking. You supported that. Then the Supreme Court approved the compacts, and no legislation was needed.

MR. VOLCKER. Texas may have been reconciled to a regional compact in which they would have been dominant. But then there was the actual collapse of the Texas banks.

MS. CARTER. The bigger ones occurred after you left, around two years into Chairman Greenspan's term.

MR. VOLCKER. Jim Baker's family had a lot of stock in Texas Commerce. I think his father founded it or something. He was always very interested. He was always careful about the way he asked. [Laughter]

The Perfect Regulator

MS. FOX. Before we leave the topic of banking regulation in that era, would you describe the perfect regulator?

MR. VOLCKER. The perfect regulator—from today's perspective?

MS. FOX. Well, it's hard to separate yourself from then and today, I guess. Describe the perfect regulator, based on your years of experience right up to today.

MR. VOLCKER. I think, and at that time I thought, that there was some value in having competition among regulators, because if you had a single regulator, that regulator gets very overbearing and rigid and doesn't want change and so forth. So competition is a good thing.

But my feeling was that so long as the Federal Reserve was recognized as preeminent, you could have the detailed supervision divided up. That was not an unreasonable way to do it. I don't know whether I ever put that in a memorandum to the Board, to myself, or whatever. But I remember writing something about what we ought to do if we were forced into a change—and there was this constant attack on the Federal Reserve by other agencies.

This comes down to the present. This might be what you do now. Why not create another agency that somehow has an umbilical cord to the Federal Reserve? Maybe the Chairman of the Federal Reserve would also be chairman of this other body, which would have its own operating head so that you would have a two-tier system—like a semi-independent banking regulator, but with close liaison to the Federal Reserve. I think that I could propose something like that. So you keep the Federal Reserve involved. The Federal Reserve Board

would have some kind of oversight, but the actual supervision would be done in this other agency.

MR. SMALL. In these interviews, we have talked about the difference between the cultures at the New York Reserve Bank and at the Board. And you said the Board is more academic and deliberative. It studies and ponders issues forever.

MR. VOLCKER. Yes.

MR. SMALL. Is that the culture in which you want banks regulated and in which you expect quick reaction to innovation?

MR. VOLCKER. Well, that's a good question. On the other hand, when it comes to a crisis, you want the Federal Reserve around. It has the authority, and it has the money in the end. We fought off the so-called Bush task force. It didn't mean that the attacks on the Federal Reserve's supervisory authority ended. There were always people who wanted to get the Federal Reserve out of that business. And, indeed, the Federal Reserve itself wavered a little bit. Bill Miller would say in public that he had doubts about whether the Federal Reserve should be the supervisor, and that caused a little angst among the Federal Reserve Banks.

MS. FOX. Former Governor Robertson argued for consolidated regulatory authority.¹⁰²

MR. VOLCKER. Did Robertson want to get the Federal Reserve out of regulation? Robertson was strong minded, and he had very strong views about regulation. He had been the deputy comptroller of the Currency. I don't know whether he really wanted the Federal Reserve entirely out of regulation.

MR. SMALL. In listening to the various stories about crises, one type of picture that emerges is that the Fed finally gets into a troubled bank and looks at the books and says, "This is

¹⁰² J.L. Robertson was a Governor of the Federal Reserve Board from February 1952 to April 1973.

a mess. Anyone could see this is a mess.” On the other hand, you just mentioned Chemical buying Texas Commerce, and perhaps even Chemical not knowing how bad Texas Commerce was. How easy is it to see what shape such a troubled bank is in?

MR. VOLCKER. Not very.

MR. SMALL. Even if you’re an insider?

MR. VOLCKER. You bring certain preconceptions to the examination.

MR. SMALL. But when Chemical was thinking about buying Texas Commerce, you would think Chemical had access to all kinds of detailed information beyond the regulatory information.

MR. VOLCKER. I think it must have. Chemical knew that Commerce had some trouble. Otherwise, Commerce never would have gone to Chemical to bail it out. No question, Commerce was in trouble. But I don’t think Chemical realized how troubled. And Chemical didn’t realize, probably, that it was caught up in the environment in Texas where all the banks were failing. If I remember correctly, Chemical thought of Texas Commerce as the strongest of the big Texas banks.

MR. SMALL. But do you think that no one knew, or that Texas Commerce would have known, but Chemical knew less?

MR. VOLCKER. Well, Texas Commerce knew it had a problem, or it wouldn’t have been interested in merging.

MS. CARTER. I think sometimes these deals are done very quickly.

MR. VOLCKER. Nowadays, of course, but I don’t think that one was done quickly. It takes you a while to realize you have to keep jumping in—external conditions change or whatever. I think that’s endemic. But it’s interesting. You’re right. Regulators get blamed for

being behind the curve, and they typically are. The bank itself often is. Some people came into my office a few months ago. They were down the line in one of the big investment banks that still existed. They were doing their own business and wanted to do a deal. But this crisis had already pretty well developed. The other day they said, “Our top guys don’t have the faintest idea what’s really going on,” which I’m sure was true.

The Fed’s Role in the Payment System

MS. FOX. The Fed’s role in the payment system is also a gift to the industry, at some level.

MR. VOLCKER. We spent a lot of time discussing the payment system—I’m sure more intensively since then. But the question of daylight overdrafts was a focal point of this concern. Traditionally, banks would not have their accounts at the Fed go into overdraft, but as they got more and more aggressive, they’d meet their reserve requirement at 3:59 in the afternoon. The rest of the day they often were in an overdraft position. I remember that I used to lie in bed and worry. They were shifting all these funds around so they would meet the reserve requirement in New York at 4:00 in the afternoon or whenever we measured it. Now, are those same funds appearing in Japan so they meet the reserve requirement in Japan with the same money? Did they move the money to Britain and then move it back here? I don’t think I ever figured out the answer to the question, but I used to worry about it.

To my mind—stodgy old banker—daylight overdrafts don’t look right to me. But overdrafts became ingrained. I looked at this and thought that if they’re forced not to go into daylight overdraft, it’s just discipline. It would be reflected in their other money market operations. They wouldn’t run so close to the edge. The idea of actually getting rid of overdrafts was beyond the pale, I guess. But we cut it back. We said, “You can only do 50 percent half the

time,” or something. We began charging them, as I remember. We both charged and said there were limits on how much they could go into overdraft. There was quite a debate about it.

MR. SMALL. Was part of that the Monetary Control Act, in that the Fed had to price its services competitively with the banking system?

MR. VOLCKER. No. I think that was a different issue. Pricing of services took a lot of time. What was the proper price? What was the cost of capital? Those two issues both took a lot of time, a lot of Board discussion.

MS. FOX. Does having the central bank involved in direct supervision and payments make much difference for monetary policy?

MR. VOLCKER. Well, Marriner Eccles wrote about this. And we’re seeing it all recur. He had a point of view that I agree with. He was concerned in the Depression that monetary policy was not as effective as it should have been, because the other regulatory agencies were so conservative in their valuation of banks and bank lending; the other agencies were inhibiting the banks from resuming active lending. The Federal Reserve was more tolerant. I think he was probably right.

Mind you, the opposite is also true. The other agencies get wound up in the industry zeitgeist or whatever the word is, and they would be too easy during boom times and then too tight during hard times. I remember the Comptroller was heavily criticized in the early 1990s for being too tough during that period of banking stresses. I’d get those complaints from banks all the time. I think the complaints were justified. But the banking regulators were too easy earlier.

The argument is, given the responsibilities of the Federal Reserve, it will institutionally be inclined to take a much more balanced view, which I think is correct. Whether we’re ready for it now or not, I don’t know. The Federal Reserve seemed to forget about that balanced view

in the 1990s. When banks and the economy are booming, you want your supervision and regulation of banks to be tough. If the economy is in a depression or a recession, the Fed would be willing to be looser on banking supervision, whereas the tendency of the other agencies is the opposite.

Financial Crises

MS. FOX. When you look back over your lifetime, your years at the Fed, and you look at the things that are going on now, what are your thoughts?

MR. VOLCKER. Unbelievable!

MS. FOX. It may appear that there is not much that can be done to avoid periodic crises.

MR. VOLCKER. Markets tend toward excesses. The analysis by Hyman Minsky is a good analysis.¹⁰³ I used to think so when I was at the Board. I didn't really know Minsky, but I met him once or twice. Mentally, or maybe actually, I'd say, "It's great. You've got a brilliant analysis. It's absolutely correct. Can you tell me how to break through this market excess so we don't have these financial crises?" Minsky didn't have an answer to that question. He said they are going to happen. The implication was, there is nothing you can do about it. It's just a question of how serious the financial crisis is. Other people have written about this, too. But some people believe that view is being old fashioned; you don't have that cycle anymore.

MS. FOX. Personally, how does it feel to be spending your life in a profession that may or may not do the job? Did you ever think of it in those terms?

MR. VOLCKER. Well, I'm probably wrong, and I'm exaggerating a bit, but I think that the Federal Reserve is kind of a holy institution. You had a system where the banks had certain

¹⁰³ Hyman Minsky (1919–96) was an American economist who proposed theories linking financial market fragility, in the normal life cycle of an economy, with speculative investment bubbles endogenous to financial markets.

protection. The rest of the market deliberately was not given that protection. It was a nice balance in that you had the key elements in the market—the banks—protected, but other institutions that could go out and innovate and be more freewheeling were not protected. By law, the Federal Reserve itself had limited instruments. So nobody should feel that the banks are going to be overly protected.

Now it all gets washed away in this great crisis. There is no guideline. The government will do whatever is necessary to support whatever it thinks is necessary. I understand that. I can't object to that, but I don't like it. [Laughter] One of the problems is that these current remedies are not consistent with the degree of independence that the Federal Reserve has. If the Fed is going to have that degree of authority, people are going to put them under greater political control.

MR. SMALL. Historically, crises involved a particular institution—say, a bank—and the terms used were “bankrupt,” “capital,” “default,” and “bailout.” Nowadays, you hear phrases like “a market seizing up,” “a market freezing,” and “bid-ask spreads being elevated.” Is this just a change in terminology, or is there a substantive difference, in that the Fed now has to be worried about the LIBOR market as a whole, for example, or that credit has escaped the banking system?

MR. VOLCKER. This incident is certainly broader and more complex. The rot has gone further and led to these other phenomena, which were always there lurking around, but in more limited sectors of the market. They weren't as all-pervasive as they are now. Particular parts of the market would come to a standstill. But it never got to the—I hesitate—I was going to say it never got to the point where the major banks didn't want to lend to each other. But, I guess, sometimes it could have been close to it.

MR. SMALL. In an October 2008 *Wall Street Journal* article, Anna Schwartz was interviewed and asked about her views on the current situation.¹⁰⁴

MR. VOLCKER. How old is Anna Schwartz?

MS. CARTER. Ninety-two.

MR. SMALL. As you might expect, she was somewhat critical of, or at least reserved in her applause for, the Federal Reserve. Her point was that the Great Depression, which Bernanke studied, was fundamentally about liquidity—whether people could get the money they had deposited in banks. The Fed is now approaching the current crisis in the same way, as if the problem is a shortage of liquidity. But, she says, it's not fundamentally a liquidity crisis. It's a credit crisis. And the two are distinct. The Fed isn't being aggressive enough in addressing the underlying problem—the credit risk in the market and the refusal of financial firms to lend to each other. Her critique is that liquidity and credit crises are distinct.

MR. VOLCKER. Well, it's usually expressed as a liquidity crisis or a solvency crisis. The solvency would be related to the strength of the credits. Textbooks and Walter Bagehot made this nice distinction.¹⁰⁵ If it's a liquidity question, the central bank ought to lend freely at a high interest rate. I long ago came to the conclusion there are very few liquidity crises that aren't related to a solvency question. There are few occasions where people aren't willing to lend unless they have a suspicion about the solvency of the borrower. Obviously, you have that in acute form now. When a financial crisis was more limited, you had some bank failures and mergers or whatever, and you got around it. When the crisis is pervasive as it is now, you've got

¹⁰⁴ Anna J. Schwartz is an economist at the National Bureau of Economic Research in New York City. In 1963, she cowrote, with Milton Friedman, *A Monetary History of the United States*, which is viewed as the definitive account of how misguided monetary policy turned the stock market crash of 1929 into the Great Depression. See Schwartz (2008).

¹⁰⁵ Walter Bagehot (1826–77) was a British businessman and journalist and the author of the work *Lombard Street: A Description of the Money Market* published in 1873.

to do something about the capital and the credit. But the credit is out in the markets. I haven't got the chart, but I was in a meeting yesterday where they had a chart.

MS. FOX. You want to draw a chart?

MR. VOLCKER. Yes, a simple chart: total credit [on the vertical axis] and years [on the horizontal axis] from 1960 to 2008. Total credit goes along merrily. In the 1980s, credit began going up like this. And then it's continued to go up like that. And you got credit out there equal to X number of times GNP, when it didn't use to be. This growth reflects the superstructure of fancy financial engineering, lending to each other and all the rest. Now we want to deleverage. Well, it ain't easy when you got whatever this is, how many trillions of dollars of credit out there. And the capital positions are so low.

And this superstructure of credit collapses. The bad loans eat into the capital. That's where we are. Credit outstanding was way up there. We sat there, or I sat there, in 1998, and said, "Why is it going up so fast? It shouldn't be. It looks bad. What are we going to do about it?" Well, we never did anything about it, because the economy was going along okay.

MR. SMALL. So if one metric of the current problem, or of the cause of the current problem, is too much credit risk per unit of capital in the financial system, you could have the Fed work on the numerator by taking some credit risk onto its balance sheet and taking it out of the market. Or, working on the denominator, you could have capital injections.

MR. VOLCKER. The Fed's balance sheet is down here [pointing to near the bottom of the chart]. It's a perfect tulip bubble. It's all interwoven with this layering of credit so the same credit gets counted six different times here, because different people own it, have some responsibility for it along the line.

MR. SMALL. You've plotted a timeline. When the Europeans, England and Gordon Brown in particular, committed to injecting capital recently, was that an important event? Ultimately, do you have to inject capital to deal with this mess? Was Gordon Brown ahead of the United States on this?

MR. VOLCKER. I don't think so. Gordon Brown came out with his proposal after the United States did. He came out much more dramatically and did it much more forcefully, so he got more credit, rightly or wrongly. But, from my standpoint, it's a heck of a system where the government is guaranteeing everything and providing all this capital. That's not the way it's supposed to work.

MS. FOX. It's not. But, hopefully, it's temporary.

MR. VOLCKER. How do you make it temporary?

MS. FOX. Based on what you learned from the way these crises unfold, is this just the beginning? The deleveraging has so much fallout that has yet to be seen in the real economy. As a central banker, what would you be looking for or worrying about for a year or two down the road? Are we again going to live through a period like you did with the Latin American debt crisis, the S&L crisis, the bank failures—all the things that we've talked about in the last number of hours where it just kept rolling along?

MR. VOLCKER. Yes, but those came all together. So maybe we handled them all together. We are guaranteeing so much now that I don't know what else we can do to guarantee anything else. What are we not guaranteeing? What else are we going to be guaranteeing? The financial markets are guaranteed. Now, the automakers want a guarantee. There's a lot more guarantees we could make. I don't know where it stops.

If I were a central banker now, I would think to myself that we have provided every guarantee we could. We still haven't restored confidence and trust. I don't know how we do that—except it's a psychological problem, and presumably confidence and trust will return over time more dramatically when people understand everything's guaranteed.

My big problem is, how do we manage the “un-guaranteeing” part? How do we get back to what it's supposed to be—private enterprise, not public controls—with as few repercussions over time as we can? It's going to be a struggle. And you can't avoid that, having done these guarantees once, when things calm down, people are going to say, “Well, they'll do it again if they have to.”

MS. FOX. Which may re-usher in the stodgy-old-banker era when the regulators have to say “no.” You're nodding “yes”?

MR. VOLCKER. Well, I think that we should use this time to develop a regulatory structure that will span the gap before the next exuberance comes along. It may not be for a while. After the Depression, banks were still very conservative into the 1960s. It took them 30 years—

MS. FOX. A working generation's memory.

MR. VOLCKER. That's right. It was something in those days. I wasn't so conscious of it at the time. The banks didn't hire anybody after 1929. They were all in the soup, and they weren't hiring anybody. There was a whole generation of young people that never went into banking. And for those that did, their memories are all about toil and trouble. The big initiative in banking in the early postwar period was to make a term loan. That was considered a radical thing to do. Lend money for more than a year, my goodness!

MS. CARTER. There was an interesting headline going back to 1984 and the Continental Illinois bailout. The headline was: “The Bank’s Historic Rescue Avoided a Disaster, but the Bailout Raises Questions about Government’s Role in Private Finance.”

MR. SMALL. I’m sure that, before this crisis, you had expressed your views about running up the trade deficit and the federal deficit, and how the chickens are going to come home to roost at some point. Some would say that the current crisis wasn’t initiated by foreigners refusing to hold our debt, so that there’s no real connection between this crisis and those deficits. Is that right?

MR. VOLCKER. There is a connection. That’s the other thing. Two charts summarize the whole thing. This thing [Mr. Volcker points to the previous chart of total credit] and the chart showing consumption relative to GDP. I just looked at these charts yesterday, so I know the numbers. Consumption used to be hanging around, say, 63 percent of GDP. In the 1990s or so, consumption got up to 66 percent. I used to complain about the lack of savings. Then we revised all the figures, and it doesn’t look as bad now as it did then. But it went from 66 to 70 percent at the peak.

And we were dependent upon this foreign influx of capital. Some of the foreign influx did go into subprime mortgages, but what was supporting this 70 percent? What was supporting it, increasingly, was housing finance. Consumers were basically borrowing against their homes; you had this process of house prices going up, and consumers borrowing against the equity in their homes. They could spend without saving, and they didn’t save anything. And as a country, we had a big balance of payments deficit that was willingly financed, and this helped keep interest rates low, which kept this process going.

MR. SMALL. What role did the federal debt play in this?

MR. VOLCKER. Well, against all these other things, it was relatively small. It was another factor attracting foreign savings. But the foreign savings came in so rapidly that it could float everything—the federal deficit, the housing. I don't know if the Federal Reserve could have fought against it, but it didn't fight against it. Money came in so easily, it would have been hard to fight against it at that time.

I try to make this point all the time. But I probably don't make it well enough or explain it enough. I think there is a definite connection between the flimsy finance and excessive consumption, which was financed broadly by markets that were supported by the flow of funds from abroad.

MS. FOX. But not a thing to be done, was there?

MR. VOLCKER. Unsustainable. As I said five years ago, this is terrible, but I don't know the answer. I don't think governments are going to change it, because it's too convenient and everybody's happy. It's likely going to come to the end in the midst of a financial crisis. That's the way we end up dealing with these problems. I wasn't quite expecting what we are now witnessing.

MR. SMALL. Earlier you mentioned Hyman Minsky, and, if I remember correctly, part of the first stage of his analysis was that we get into this debt overload, and then, in the second stage, the government would have to inflate its way out of it.

MR. VOLCKER. I don't know if he got into the inflation business. I don't remember it that well. Yes, now we're in the crisis point. Beyond the crisis point is the destructive point. And that will so chasten human behavior that you'll have a very calm period where nobody will engage in any excesses. But as things return to normal and business gets better, confidence returns, and then the process of lending builds upon itself. And the more it does, the more

encouraged you get, and it goes to an extreme until you have another crisis. Then the process starts all over.

Fannie Mae and Freddie Mac

MR. SMALL. Were you working at the Treasury when Fannie Mae [Federal National Mortgage Corporation] and Freddie Mac [Federal Home Loan Mortgage Corporation] were set up?

MR. VOLCKER. Freddie Mac was later. I was a director of Fannie Mae. You didn't know that? Fannie Mae wasn't just government-sponsored, it was a government agency. I have a feeling I was a director of it at some point when Fannie Mae was still a government agency. But I saw some timing thing that suggests that wasn't true.

At the same time I became undersecretary, there had been a budget commission. I think it was headed by [David M.] Kennedy. The current unified budget concept grew out of that commission. But they had a little fly in the ointment, which was that Fannie Mae and some other agencies were on the budget.

The way the budget was calculated and the way Fannie Mae loans were calculated, every time Fannie Mae made a loan, it was counted as an expenditure, so it made the deficit look bigger. The commission thought that was illogical. Fannie Mae was making loans, but they were good loans, so that shouldn't add to the budget deficit. That should be a separate operation consistent with the budgetary rules. The commission recommended that Fannie Mae be taken out of the budget and privatized. Fannie Mae would still have public responsibility, but it would be privatized.

I became a director when they privatized Fannie Mae. The President appointed some of the directors. Because I was undersecretary for monetary affairs, I was designated as a director of Fannie Mae. I would go to the board meetings.

Fannie Mae began acting like a private company, which was at a low level in those days. But Fannie Mae wanted a fancy office building, and it wanted high salaries. I was a government bureaucrat. I said, "What are you doing? We made you private just to get you out of the budget, not to go feather your nest." I was a grumpy old man who was objecting. It was at a very low scale. It was a question of, should you pay the president of Fannie Mae \$200,000 or something. Government salaries were \$40,000. There were no stock options. But Fannie Mae began acting like a private company. I was a director until I left office, I guess. So I was probably a director for four years or something. I don't remember how long.

Anyway, Fannie Mae really did act like a private company. It got beyond itself. It's in a terrible position. [Richard F.] "Dick" Syron, former chairman of Freddie Mac, felt awkward in this later period, because the whole concept is flawed.¹⁰⁶ You're told to follow a public purpose and support the mortgage market on the one side and be a private company and have stockholders on the other side. You have a fiduciary duty to the stockholders that at times will conflict with your public purpose. They had this great and very profitable stockholder performance. They exhausted all of their capacity. So when the crisis came along, a crisis that Fannie Mae and Freddie Mac presumably were created to deal with, they were left holding the bag.

MS. FOX. Did you talk to Dick Syron before he took the job at Freddie Mac?

¹⁰⁶ Richard F. Syron was chairman and CEO of Freddie Mac from 2003 to 2008. He served as assistant to Paul Volcker as Fed Chairman in 1981 and 1982. He was president of the Federal Reserve Bank of Boston from January 1989 through March 1994.

MR. VOLCKER. Logically, you would think I did, but I don't specifically remember. He wanted to change jobs then.

MS. FOX. He was your special assistant at one time.

MR. VOLCKER. As I remember, he was an economist at the Boston Federal Reserve Bank. I think he went to the Treasury, maybe with Bill Miller. Bill Miller had been a director of the Boston Federal Reserve Bank. Probably what happened, although I'm reconstructing, is that Dick was attached to the Democratic Administration, so when the Administration changed, he was out of a job. I had him as assistant for a year or so. I think he went directly from being my assistant to the Boston Home Loan Bank. He got involved in the savings and loan crisis. That work was very successful. After that, he became president of the Federal Reserve Bank of Boston [1989–94]. Then he became head of the American Stock Exchange [1994–99], much to my surprise. I was on the board of the American Stock Exchange. I was on the committee to get a new head, and he suddenly appeared. It amazed me, so I recused myself. He got the job. Then he went to Thermo Electron, a high-tech company, in Massachusetts. It was a tough time. The company was not in very good shape, but that came out all right. Then, I guess, he got tired of it and wanted a new challenge and went to Freddie Mac. But I do not remember talking to him about going to Freddie Mac.

Latin American Debt Crisis in 1982

MR. SMALL. You said that the Latin American debt crisis started with the OPEC price increase and the recycling of petrodollars. Could you explain the recycling issue?

MR. VOLCKER. Well, you had a large increase in oil prices, and Middle Eastern oil producers were making tons of money. The question that preoccupied everyone was, what should they do with all that money? There was a lot of wrestling around. Should there be new

governmental instruments? Several were proposed, and, I think, one or two were actually legislated. But I don't remember all the details of that.

Big banks, meanwhile, provided an intermediation function. From the standpoint of the people with the money (the oil producers), the big banks were good, safe places to put their money. Then, of course, banks got all these deposits. They had to do something with the deposits. Latin America was, I guess, in deficit because of the oil embargo. They were in deficit anyway. They weren't doing very well, but there always were recurring hopes about developing countries. They were not the only one, but they were a big market for the bank loans. And the banks charged reasonably high rates. They paid low rates to the sheiks and demanded high rates from the dictators. That process went on.

It was not unlike the subprime crisis. You have a lot of money. What do you do with it? You lend it to people willing to pay a lot of interest, but they're weak borrowers. It was like the subprime crisis in that this became the fashionable thing to do. Banks that had no interest traditionally in foreign lending piled in there and made loans. They thought, "If Citibank is making loans, if Chase is making loans, it's good enough for me. I want to be in on it too." They would go around either joining the big bank syndicates or going around on their own: "We have money. Would you please borrow?" So it was very much like the period of increased subprime lending.

I don't remember what happened to the official recycling. There were ways to keep it presumably orderly and less risk prone. I think some laws were passed, but I don't think the Republican Administration's heart was in it—[William E.] "Bill" Simon and so forth.¹⁰⁷ I don't know. I'm going beyond what I remember.

¹⁰⁷ William E. Simon was the Secretary of the Treasury from May 1974 to January 1977.

All I know is, at the end of the day, these loans were building up rapidly. And, again, like the present situation, everybody was happy. The oil countries had a place to put their money. The banks were making money. The Latin Americans were borrowing easily and growing. What's to worry? It's very similar to this recent thing.

As I said the other day, Arthur Burns was one of the lone voices that kept warning about this in the official sector. We tried to do some things within the Federal Reserve, but we were not very effectual. Make a nice, nuanced approach toward slowing it down: a little traffic system of green lights, yellow lights, red lights.¹⁰⁸ And time passed. Nothing much was happening except that the process was going on. I guess we're going through Bill Miller's term as Fed chairman, or whether we started this venture in Arthur Burns's term—I don't remember any particular position Bill Miller had during the interregnum. But then I eventually became Chairman, and it was still going on. I remember making a speech at NYU, one of the few speeches I didn't draft.¹⁰⁹ I was uneasy about it. I discussed this problem and took a nice nuanced position. Yes, this was going too fast, and I'm sure it's unsustainable. But it's not unmanageable at this point. With prudence and temperance, we'll manage our way out of this. I was never happy about that speech.

MS. FOX. You weren't happy about it because it wasn't strong enough?

MR. VOLCKER. Yes, what could you say? You couldn't say, "This is terrible. It's got to stop, or we'll have a crisis." But I didn't want to praise it, either. So you're caught in this nuanced in-between position. I'm sure that the speech had no impact on anything. When it began to change was in 1982 when the market suddenly shut off Mexico. Banks were lending very freely to Mexico, and then, as I remember, in the winter of 1982, they suddenly stopped.

¹⁰⁸ See [previous discussions on green, yellow, and red lights] on page[s] 71 [and 166].

¹⁰⁹ See Volcker (1980).

MR. SMALL. How much of this lending was put in place at low interest rates before you became Chairman and ratcheted up interest rates?

MR. VOLCKER. They were heavily indebted by the time I came along. The high interest rates, of course, hurt them, because they were heavily indebted and the interest rates went way up on them. August 1982 was when the crisis really broke. It was early 1982 when the money stopped flowing. This left-wing guy, José López Portillo, was president of Mexico [from 1976 to 1982]. When the music stopped, he kicked out his finance minister and had a new finance minister, Jesus Silva Herzog. Silva Herzog was, in my opinion, a responsible guy.

Silva Herzog began the practice of coming up to see us once a month, as I remember. He wanted to see the Federal Reserve and the Treasury because he knew that he was in trouble. I guess Mexico had enough liquidity to last for a while. The Treasury wasn't much interested. It was anti-bailout and free markets. Treasury didn't want to get pulled into helping a foreign country. We just had gotten rid of our involvement with Chrysler and so forth.

When Silva Herzog came to Washington, he didn't get much tea and sympathy from the Treasury, but he got it from me. We had a pretty good relationship. He used to come up on Friday when the Federal Reserve had lemon meringue pies for dessert. He would joke about that. He got sick and tired of lemon meringue pie. But there was nothing much you could do at that stage about Mexico's financial situation. Mexico wanted to keep it quiet, and he could see the crisis coming. There wasn't anything he could do so long as López Portillo was president. We could see this building up.

At some point along the line, we insisted that they tell us precisely what their reserve position was, which they'd never done. We extracted some information from them. There were only two days a year when Mexico published its reserve position. For some reason, one of those

days was in May when there was a banking convention or something. One was in the fall. The reserves were getting pretty low. They didn't want to publish their reserve position, because they thought that would set off the crisis. López Portillo was in the midst of an election. What could you do in the midst of an election? So we lent money overnight to window-dress their reserve position. We had an established swap line with Mexico. They wanted to draw on the swap line. So we responded to their request and lent the money overnight, which one probably wouldn't do now—I don't know if one would or wouldn't. But anyway, they window-dressed their reserve position. So we got over that particular threat.

MS. FOX. Was the Treasury Department still hands off?

MR. VOLCKER. The Treasury knew what we were doing, I'm sure, but it was not really motivated and energized. The Treasury was pretty passive. Then a month or two later, whenever it was, Mexico kept losing reserves, so we lent it some money—all this must have been published. We reported all this stuff later in the normal course of things, but we didn't publish it at the time. We lent Mexico enough money that, we calculated, would hold it through the summer. That was important because, while López Portillo's formal term was up in November, it was a Mexican tradition that the outgoing president made a big speech in September; then he left the field, and the incoming president took over.

The incoming president was Miguel de la Madrid, who we thought was a responsible guy. Silva Herzog was his finance minister. The central banker, Miguel Mancera, was a very prominent, well-respected central banker who we all knew. So we had a team there and a prospect that, if we can get them through September, the government could take action. So that was the theory. I'm sure the U.S. Treasury must have known about it.

MS. FOX. When you were talking about “we,” I know it’s the “royal we”—the Federal Reserve—but it was Ted Truman and you. Was there another Board member involved?

MR. VOLCKER. Well, the Board and the Open Market Committee had to be involved. We were lending the money. I don’t remember. Henry Wallich was the international guy.

MS. FOX. There must have been discussion about what the Fed had the legal authority to do.

MR. VOLCKER. We had an outstanding swap line. Mexico was just drawing on the established swap line. It was a traditional practice. We did not always have to respond to requests to draw. There were a lot of uses of swap lines over the years. It was very unusual to refuse a request. We could have, but this was the strategy: We had to get Mexico to their new president.

Unfortunately, Mexico ran out of money in August, so then we scrambled. We lent Mexico more, maybe through the swap line. The Treasury reluctantly got involved, finally. First of all, we went to the BIS and said we’ve been lending money to Mexico: “Come on, boys, join in.” There was some reluctance. But we got a lot of help from the Bank of England, from Gordon Richardson, and from the Swiss National Bank. All the big commercial banks were at risk. I don’t remember the Swiss banks being particularly involved. But Fritz Leutwiler, the conservative Swiss central banker, was a good friend, and he was very helpful. He recognized this was an international problem, not just an American problem, and the BIS ought to get everyone together. So, with some reluctance, there was a credit line from the BIS for a while.

The United States government, someplace along the line, finally lent Mexico some money. I don’t know if it was the Export–Import Bank or some agricultural fund or another fund that was scraped together. Initially, there was a little roadblock. Whatever U.S. agency it was, it

wanted to charge Mexico a very high interest rate. That wasn't the way to do it—to charge this extraordinary interest rate when you are trying to help. López Portillo went through the roof and called President Reagan, as I remember. By this time, the Treasury was fully involved, but with some reluctance. Fortunately, the deputy secretary of the Treasury, Tim [R. Timothy] McNamar, was joining in with a more or less full cooperative mode. He was involved and got things done. Tim McNamar did a lot to get some coordination from the rest of the government.

Then, in August, Mexico was out of money. We arranged a meeting at the Federal Reserve Bank of New York that you couldn't arrange now. Mexico invited about 100 bankers—all the main bankers to Mexico. We got them in the room with Silva Herzog and his assistant Angel Gurria, who's now head of the OECD, but he was a young fellow at that time with a big beard.¹¹⁰ I was sitting upstairs. I didn't think any Federal Reserve official should be at this meeting and appear to be putting moral pressure on the banks, but the approach the Mexicans proposed was planned.

Silva Herzog was quite an actor. He went in front of these bankers and said, "My name is Jesus, and I have with me an Angel. We don't have any money, but you don't have to worry. We're out of money. It's unfortunate. We don't want to default. So it would be nice if you didn't press for payment. Not only that, it'd be nice if you lent us some more money, because we're going to need some more money to survive and pay interest. What do you think about that?" The bankers were stunned, and nobody answered. Then he said, "Thank you for your approval."

I don't know if he suggested it or the banks did, but a committee was set up among the banks to consider this and develop an approach. Citibank, which was heavily involved, was very

¹¹⁰ Editor's note: Angel Gurria became Secretary-General of the Organisation for Economic Cooperation and Development in 2006.

helpful in taking the lead and organizing this. For Bill Rhodes, who's been around forever in all these international things, this was his baptism. He had been Citibank's guy for Latin America, so he was put in charge. He was the right guy. He had a talent for this. For him, it wasn't just how much money can Citibank make out of it. Citibank had a big interest, but he had to satisfy all the main banks.

So that negotiation went on. I don't remember when that was resolved. But things really got tense at the IMF meeting then, which was in Toronto, because López Portillo nationalized Mexican banks. Miguel Mancera, the respected central banker, resigned out of frustration.¹¹¹ Silva Herzog was up there in Toronto. He agonized with me about whether he should resign.

MS. FOX. And what was your argument to Herzog?

MR. VOLCKER. Well, I thought he was a good guy, and I wanted him to stay in office. He was continuity. I said, "Hang in there. We'll try to arrange something, because this is the last hurrah for López Portillo. Now he's effectively out of the picture. But you stay in there, and we'll try to get this together."

I guess that at one point, the banks in Mexico had been forbidden to make dollar payments. So that avenue of reserve loss was shut off. But they had branches or agencies in New York, which had deposits. The rule didn't reach those. We sat up there in Toronto. Sam Cross [Manager for Foreign Operations at the NY Fed] was delegated. He kept in touch with these two or three agencies of Mexican banks. They would say, "Look, one of the companies that has deposits with us wants to take out \$10 million. What are you going to do?" We would say to those agencies, "Tell them they can have \$5 million." The idea was for the Mexican

¹¹¹ Miguel Mancera returned to the office of director general of the Bank of Mexico in December of 1982.

banks to survive for a few days without anybody taking them to court, because their depositors all got some money out of it—with hope for more.

We organized some more central bank and BIS support with the great help of Gordon Richardson, the widely respected governor of the Bank of England. We got money to lend to Mexico, which got us over that initial crisis, but then we had to wait. The commercial banks that had lent money to Mexico stood still; they didn't bring any legal action.

MS. FOX. At that point, in the group that Rhodes was coordinating, were the bankers taking a haircut at all? Were they making new loans?

MR. VOLCKER. At that stage, I don't think they had been organized enough to make new loans, but they weren't demanding payment on the old loans.

MS. FOX. So everything was at a standstill.

MR. VOLCKER. It was just at a standstill. Now, what was the Federal Reserve doing all this for? This is not the ordinary function of the Federal Reserve, to be managing this thing and organizing commercial bank lending. The Treasury wasn't managing it very eagerly, although they were cooperating at this point. I finally decided we better go to the White House on this, get a common understanding, agree who would take the lead, and get the Treasury on board or off board or whatever.

MS. FOX. To what did you attribute the Treasury's lack of interest? Did Treasury want it to be your headache, or was the Treasury just not aware?

MR. VOLCKER. I think their lack of interest started out as basically ideological: "We don't want to get involved in all this bailing-out business. That's not our business. This is free enterprise," so forth and so on. But the Treasury never objected to what I was doing; the Treasury just didn't want to take the lead.

MS. FOX. But McNamar was helpful?

MR. VOLCKER. McNamar was helpful. Treasury never suggested I was violating anything, exceeding the Fed's authority. The Treasury didn't want to get involved, but it didn't want to pull the plug, put it that way. But it wasn't quite right to leave it there. I thought we ought to straighten it out. So I wrote some kind of memorandum. It went to Baker, who was then the all-powerful chief of staff. The meeting was very short. He looked at the memorandum or had it described to him. The bottom line was that we had to help Mexico continue to service its debts.

MR. SMALL. We had to help Mexico both to prevent contagion to other Latin American countries and to protect American banks?

MR. VOLCKER. Absolutely, for both reasons. At that time, the big banks in New York had total exposure to Latin America that was more or less equal to their capital. Some of the other big banks around the world were in comparable positions. So, if Mexico actually defaulted and the banks had to write down Mexico's loans, they would have been in deep trouble as the crisis inevitably spread, and Mexico would be hurt as well.

MS. FOX. It was like what happened later with Long-Term Capital Management or whatever, where the banks didn't know what each other's exposure was? They didn't know in total?

MR. VOLCKER. No, I think the total figures were published, as I recall, even then, but perhaps not by country. They certainly were later, but I think some overall data were then. Individual figures were published later.

MS. FOX. Ultimately, the International Lending Supervision Act became law in 1983. That act created the report that Mike Martinson [assistant director in the Board's Division of Banking Supervision and Regulation] put together. Do you remember that?

MR. VOLCKER. No, but I think the totals were known. I think that speech I made at New York University had all the totals. For individual banks, you had just what they reported. They didn't report very fully, but they were exposed. In those days, you didn't have to write the loan value down to market, so they kept it on their books. But they were heavily exposed.

Sometime along the line, I made a speech, as I recall, in Boston, where I said, in effect, "If a bank keeps lending and keeps Mexico and other countries afloat, we will not take critical supervisory action with respect to those loans."¹¹² By implication, "those loans" were the outstanding loans. The speech was necessary to reassure the banks they would not be criticized for lending. We were worried about the banking system all right, but we also felt the Mexican crisis was contagious. I can remember meeting with the head of the Brazilian central bank in Toronto. He said, "Don't worry about us. We are very careful debt managers, and we've got this all tiered up. We're not exposed." Two months later, there was a run on Brazil.

Someplace along the line, fairly early, the IMF got involved. I don't remember how early the IMF made its first loan to Mexico, but we worked very closely with the Fund. The Fund developed an approach consistent with what we were doing—if banks make loans large enough

¹¹² "It is equally a fact that, given strong and necessary adjustment programs, borrowing countries will not require bank financing in amounts nearly as large as the sums provided by banks over recent years. Indeed, lending banks, working effectively together to meet a clearly justified transitional need, should be able to provide the necessary margin of finance while reducing ratios of outstanding loans relative to their capital or assets. . . . From the standpoint of the banks themselves, such restructuring and the provision of some additional credit, alongside and dependent upon agreed IMF programs, will in some instances be the most effective and prudent means available to enhance the creditworthiness of borrowing countries and thus protect their own interests. *In such cases, where new loans facilitate the adjustment process and enable a country to strengthen its economy and service its international debt in an orderly manner, new credits should not be subject to supervisory criticism*" (emphasis added; Volcker, 1982b, p. 17).

to carry forward the affected Latin American countries and those countries agree to meet strict IMF conditions, the IMF will lend them money too and will bless the whole thing. But the IMF wouldn't lend them money unless banks did. That approach was repeatedly used with Mexico, Brazil, Argentina, Colombia, and a few countries outside Latin America. And that went on. That was the daily management of getting all the banks corralled. Bill Rhodes did it the first time. He ended up doing that for most of the countries.

Walter Wriston was fully cooperative; Citibank was, of course, in jeopardy. Morgan Bank was very cooperative—it was in less jeopardy; Lew Preston was a very responsible guy.¹¹³ So the IMF and the countries had the support of those big banks. Chase went along. Charlie Sanford at Bankers Trust, for one, didn't want to put in new money.¹¹⁴ Some banks were more recalcitrant than the others. The Fund's approach was to insist on 90 or 95 percent coverage by the lending banks, I think. Meeting that requirement would trigger IMF loans. There'll always be some holdout banks; we didn't like to strong-arm banks, but somehow the banks had to be convinced it was in their own interest. And, of course, you had the free-rider problem. But it worked.

Of course, part of the price of those countries obtaining loans was that the IMF had stringent conditionality on the countries themselves. We were working hand-in-glove with the Fund, so we would develop these conditionality programs that the countries had to agree to, which made for some restiveness. Finally, as time passed, we got the World Bank involved too. I undermined all the good disciplines of the World Bank—of insisting on careful appraisal of individual loans for particular purposes—by saying, “Forget about all these particular things, go

¹¹³ Lewis T. Preston was chairman of the board and CEO of J.P. Morgan and Company at this time. He served as president of the World Bank from 1991 to 1995.

¹¹⁴ Charles S. Sanford was chairman of Bankers Trust from 1987 to 1996 and, before that, had been the company's president.

lend the Latin American countries money in support of adjustment programs.” And the World Bank began to broaden its horizon and lend more. [Alden W.] “Tom” Clausen was the president of the World Bank [1981–86]. Ernie Stern was really running the bank day-to-day. The World Bank didn’t do much lending at first, but it eventually got involved.

To cut the story short, this went on in country after country. It worked for a couple years, but then it became more and more difficult to get the banks involved. The problem didn’t go away. We tried to reinvigorate bank lending through what was called the “Baker initiative.”¹¹⁵ James Baker had become Secretary of the Treasury. He was not instinctively against all this stuff the way Don Regan was. Baker was a full participant. We made up this plan that he correctly said later was largely my plan, but it got called the Baker plan because he initiated the program publicly. At the time of the IMF meeting in Seoul, which would have been after three years, we tried to get the thing reinvigorated, because everybody was getting tired. The bar was getting higher. The Baker initiative worked to some extent, but it petered out more than I had hoped.

MS. FOX. What did the Baker initiative propose?

MR. VOLCKER. Well, it just developed, in a more organized way, what we were doing earlier case by case. By that time we had gotten the World Bank involved, we collectively judged how big the overall need was. As I recall it, the Fund would cover a quarter of it, and the Bank would cover a quarter; the commercial banks had to cover the other half. And we’d proceed in accordance with that. It was regularizing what we were doing. The point was to get

¹¹⁵ The Baker initiative responded to the debt crisis occurring in several developing countries by proposing that national debts in 15 countries be further rescheduled by private-sector banks. The initiative also requested increased lending from the World Bank and the Inter-American Development Bank to those 15 debtor nations.

an overall commitment from the commercial banks instead of doing it case by case. And it was not fully successful.

MR. SMALL. Here's what you had to say in the chronology of your book [showing Mr. Volcker a page from his book *Changing Fortunes*].

MR. VOLCKER. Right: “. . . ‘growth-oriented adjustment’ with additional lending by the World Bank and \$20 billion by commercial banks over three years. IMF reform programs continue to be a condition for loans. Although the Europeans and Japanese [endorse] the Baker plan, as it [comes] to be known, they and the commercial banks [withhold] the money that might make it viable.”¹¹⁶ I don't remember that last part.

MS. FOX. While all of this was going on over years, there was some level of public interest in it. The Congress was mostly upset about the banks having 100 percent of their capital exposed and about whether the regulators had been at fault by not catching that. The Congress passed a law that said the regulators had to watch bank exposures more carefully.

MR. VOLCKER. There was a lot published at that point, with enough detail about what loans banks had—which countries, which areas, whether the loans were fully paying or not fully paying. That may have been in response to legislation or otherwise. But we were not, in general, classifying these loans. And it's the kind of argument you have now, about marking to market: “Tell the truth” business. The banks weren't doing much reserving, which made me unhappy. When I would encourage them to do more reserving, they would argue, “It's not going to do us any good to reserve 5 or 10 percent, because if a country goes bad, the problem is much more than 5 or 10 percent. Overtly reserving 5 or 10 percent is only going to get people more

¹¹⁶ See Volcker and Gyohten (1992, p. 357).

worried than they are now. So we're better off doing nothing." I don't know if that was factual or not, but, anyway, they didn't do it.

Eventually, there was a growing feeling of "What are you doing here? You're covering up bad loans." So the activation of the Interagency Country Exposure Review Committee [ICERC] may have been in response to legislation.¹¹⁷ We established this thing where a team of examiners had to report on the liabilities of particular countries. The ICERC rated the country. If a country rated badly enough, then we had to do something. The examiners came in, and they reported to me. I guess I was not supposed to influence this process, but I probably did, simply because I think they reported to me. I think Ted Truman was running it. Anyhow, we skated along.

Before I left the Fed, we had more difficulty with Mexico. We heard a rumor that President de la Madrid was about to order Mexico to default on its debt obligations, and there were reports Silva Herzog, my buddy, was urging Mexico to default. I don't know what happened.

MS. CARTER. You've got something in *Changing Fortunes* about the Baker plan being in trouble in the spring of 1987. Something about John Reed—coup de grâce was taken by John Reed.¹¹⁸

MR. VOLCKER. I think this must have been before that. Anyway, it was in the middle of the summer sometime. It must have been the middle of the summer in 1986, around July 4th.

¹¹⁷ The ICERC [established by the FDIC, the Federal Reserve Board, and the OCC in 1979] is responsible for providing an assessment of the degree of transfer risk that is inherent in the cross-border and cross-currency exposures of U.S. banks. *Transfer risk* refers to the possibility that an asset may not be serviced in the currency of payment because of restricted availability of needed foreign exchange in the obligor's country. Transfer risk is one facet of *country risk*, which encompasses any and all uncertainties arising from the economic, social, and political conditions in a country. Country risk is also an important consideration when evaluating the level of credit risk associated with individual entities in a country.

¹¹⁸ See Volcker and Gyohten (1992, p. 215).

I flew down to see President de la Madrid. I said, “What’s all this about? I hear you’re going to default.” Both de la Madrid and Silva Herzog denied that was their intention. Carlos Salinas later got credit for opposing the default. Salinas was about to become president.

MS. FOX. Silva Herzog had been fighting along with you all this time to keep the thing together. Suddenly, out of the blue, he says that Mexico has to default?

MR. VOLCKER. Well, he may have said that. I was never quite sure.

MS. FOX. And President de la Madrid also had been responsible to that point. But he was probably under a lot of domestic political pressure, because that was Mexico’s “lost decade.”

MR. VOLCKER. They were in the middle of a tense negotiation with the IMF and the United States about whether they were meeting the conditions set.

MS. FOX. So, potentially it was a bluff—or a threat, maybe—to put some heat on the negotiations with the IMF.

MR. VOLCKER. I don’t know. When I went to Mexico to meet with President de la Madrid, he said straight out, “I’m not going to default.” And Silva Herzog claimed that he was against default.

MS. FOX. How did the rumor of the default threat get to you? Was it through the markets, bankers, or someone like Mr. Yeo?

MR. VOLCKER. I think it was probably through the CIA or something. I don’t know. I don’t think it was the market. It may have been partly through some CIA contacts. Well, that stuff that comes through the CIA is often garbled anyway: Somebody said something and somebody else said something else. But there was no doubt there was discussion of it. I took a very quick trip to Mexico City. I don’t know that Yeo was involved. He was aware of it, but I

don't think he was the one. Anyhow, a default by Mexico didn't happen, but the atmosphere was not highly conducive both on the banks' side and on the Mexican side. They were all getting tired.

It became increasingly clear that we had to think of another scheme to get some air back in this balloon. And then John Reed walks in, brand-new chairman of Citibank. He says, "I'm going to reserve against all this." Took a 40 percent reserve, 50 percent reserve, whatever it was. Proud as a peacock. And what he was doing was sticking his thumb in the Federal Reserve's eye by taking these reserves and announcing the end of this joint effort. But it wasn't just that. He wanted to declare his independence from Walter Wriston, who had gotten Citibank in all this trouble. John Reed was the new head, and he was going to take a fresh view. He thought by that time that Citibank was in a better position amongst its competitors, and he could afford to do this reserving and they couldn't. So it was a combination of the old Citibank sticking it to the Federal Reserve, sticking it to his predecessor, sticking it to the other banks. And, of course, he was greatly applauded because he stood up for reality. I still don't understand the reaction. Citibank's stock went way up, and the value of Latin American debt went way down. That seemed somewhat inconsistent to me. But anyway, that's that. A few months later, I left the Federal Reserve.

Brady was not yet the Secretary of the Treasury. When he came in and saw all this, he said—I think, quite rightly—that a new approach was needed. So he dreamed up the plan for converting, on an optional basis, the remaining debts into long-term securities guaranteed at maturity by escrowed U.S. government securities. The participating banks took something of a haircut—which at that point was a small haircut, as it turned out. While it was to some financial advantage for the borrowing countries and certainly lengthened their debt, which was positive,

the actual reduction in the debt wasn't all that much. But there was a great sense of relief that this was now finally pushing it out and settling this long-term crisis.

MS. FOX. Instead of loans, they were mortgages. Was that the Brady plan?

MR. VOLCKER. That was the Brady plan. The debt became secured.

MS. FOX. Was there a consideration earlier of replacing the loans with some kind of long-term guaranteed—

MR. VOLCKER. Well, right from the beginning, academics and others had a field day. There were op-ed pieces about how to handle the Latin American debt crisis—one version was to refinance all the debt and have a 10 percent haircut for everybody across the board. The idea of something different from what we were doing had some purchase in the Congress. These people would go up and testify. There was a Kenen plan, I remember, that was basically giving a haircut to all the loans.¹¹⁹

MS. FOX. When the debt crisis initially started, could the banks have taken a haircut?

MR. VOLCKER. Well, they could probably have afforded the haircut, but a 10 percent haircut wouldn't have done anything. It would just have cascaded down. You couldn't break the line of par value, in effect, without creating a cascading downward revaluation, because 10 percent wouldn't have been enough. You want to get much more; you wanted some conditionality. And a 10 percent reduction in the existing debt did nothing. The countries needed new money. Where were they going to get the new money from?

MS. FOX. Right. And once the loans were reserved against, the banks couldn't put in new money?

¹¹⁹ Peter Kenen was an economics professor at Princeton University.

MR. VOLCKER. Yes. And the terminology which you often see now in other crises, which was our argument, was that you have to do it “case by case.” Do it for Mexico, the particular problem there. The IMF will have a particular program suited to Mexico. The amount of money that’s needed will be tailored to Mexico. Brazil will have a different program. Similar, but the amount of money involved was presumably related to the particular needs of that particular country.

Brazil did almost default. As this thing unraveled, Brazil kept having a new central banker and a new finance minister, it seemed like, every 18 months. They finally got a very aggressive one: “We’re going to default. Can’t scare me. We’re going to.” It came very close, but I don’t recall that Brazil defaulted.

MR. SMALL. For people who would worry about moral hazard in all this, in the end, how much of a hit did the U.S. banks take financially?

MR. VOLCKER. Well, the banks were making loans at a rate that they considered way below market. The loans were all based upon the LIBOR. I think the standard was something that developed. Once you created the precedent, everybody followed it. I think it was LIBOR plus seven-eighths or something, which would have been low considering the circumstances. It wasn’t a great penalty rate, either.

John Reed became Chairman of Citibank [1984–98]. He was born in Illinois, but he was raised in Argentina and Brazil. I think his father was a businessman or something in Argentina. He had a plan in his mind for dealing with Mexico, saying, in essence: “I’m just back from Argentina, and I have a different way of doing this. This is the way you have to do it.” And our response was that we had this all arranged, 12 banks, and you’re going to come in at the last minute and tell us we have to do it some different way? The IMF meeting must have been in

1986. The banks, at the point of decision, couldn't resolve the terms of the loan arrangement between Mexico and themselves. They debated it and they debated it. There were threats of pulling out by the banks and defaulting by the Mexicans. But anyway, it all got settled except the interest rate. I think the banks wanted the standard thing with seven-eighths.

MS. CARTER. That's what you have in your book—seven-eighths, and they were quibbling over an eighth of a percent.

MR. VOLCKER. Mexico said they wanted three-quarters. And the banks said that Mexico can't get three-quarters; it was going to be seven-eighths. I was sitting in on part of this meeting. All the banks were there, the 13 banks or something. They sat there and haggled and haggled and nothing happened. They were getting sore at each other. It was mainly Reed who said seven-eighths. He essentially said, "I'm not going to agree. It's got to be seven-eighths." The other banks were angry when he said that. Finally, I said, "Why don't you compromise? Why don't we make it thirteen-sixteenths? Why don't you do half at seven-eighths and half at six-eighths?" They didn't like that. I said, "Why don't you do the whole thing at thirteen-sixteenths?" And I left the meeting: "You settle it." An hour or so later I got the word that they had all agreed unhappily on thirteen-sixteenths. It saved a little face for Mexico and saved a little face for Mr. Reed, I guess. So you had the silly thirteen-sixteenths interest rate. And that interest rate applied to everybody. But that was probably the last big program with Mexico. The next one that was being negotiated in the end gave way to the Brady initiative.

MS. FOX. How involved were you in the development of the IMF programs and the great debate that ultimately occurred over whether they were that good or bad?

MR. VOLCKER. I was very involved. Jacques de Larosiere [managing director of the IMF from 1978 to 1987] and I were working hand-in-glove. But the difference in that and the

Brady plan was that Brady came in, looked at this, and immediately accepted it as a Treasury responsibility. Brady wanted to get this off his back, and he had his people develop this plan. At that point, the Treasury really took over, which it should have done in the first place.

MS. FOX. When you left the Fed, did you feel pretty confident that the debt crisis was coming to an end? That the programs were working?

MR. VOLCKER. Well, by that time the poison had been partly drained out of it. They'd had five years—bank profits and so forth. While the remaining loans outstanding increased, I'm sure they were a smaller percentage of their total assets, and their capital position was better protected. There were still some vulnerabilities, but it wasn't a crisis where you felt that if one nail came out, the whole thing would collapse. I suppose it still could have. But I think the popular perception was that the Brady plan was a great concession in money. It was some concession, but the banks had a choice. They could accept the terms of the Brady plan or continue with what they had. Some of them just kept what they had, but most of them took the Brady plan.

MS. FOX. How did the whole thing play into your calculations about monetary policy? What did you worry about when all that's going on in a whole section of the world?

MR. VOLCKER. Well, the great incident that other people talk about, other members of the Board and so forth, was in June 1982, where I told them the world was falling apart and we shouldn't tighten up. At that point I was very restless about interest rates and the economy, regardless of this Latin American debt thing. I didn't want a policy tightening on top of the debt problems. I guess there may still have been some sentiment to tighten money further. That may not be true, but there certainly was resistance to easing. My concern was to get the Board and

the FOMC more oriented toward it being the time to ease. I'm sure the debt crisis was consistent with that. But I had enough motivation in the domestic economy.

More on Too Big to Fail

MS. FOX. An awful lot of your time and that of your colleagues at FDIC and other places was spent making sure that we didn't lose some of the big banks. There was a raging debate about the unfairness of that. Small bank after small bank gets shut down. Depositors are paid off, but nondepositors lose their money. For big banks, systemically important banks, whatever you called them at that time, the Fed and other regulators ride to their rescue. What was your view of that debate?

MR. VOLCKER. I think the critics had a point. But I don't know what to do about it. Those questions didn't arise in connection with the Latin American debt crisis. They arose with Continental Illinois and the others. It got pretty intense, the charge led by Ken Guenther. I don't think uninsured depositors were losing very much in those things. Small banks had small deposits. I don't think there were any banks that really lost a big amount of uninsured deposits. But, from the banker's standpoint, that didn't make any difference. The bank was bust. So it's not a good answer. Today, we have nothing hidden or ambiguous about it. In the United States, the big banks are going to be saved, period.

MS. FOX. There were discussions along the way of things such as to charge the big banks more for deposit insurance. Things like that.

MR. VOLCKER. They always claim they ought to be charged less. For the big banks, the deposit insurance fee is paid on total deposits. And they said, "Our insured deposits are a tiny fraction of our total deposits. Why are we paying a fee on our total deposits when you're

only insuring our small deposits? I don't think they carried that too far, since they were all being protected anyway. That was a formal argument they made.

I don't know what to do about it. I think the answer is that if you're proposing reform, given what's happened recently, it's not realistic to say we're going to have a system where the big banks are not fully protected, because nobody would believe you if you said that was the system. You can subject them to relatively more intensive examination, and you could do that more formally than you've done it in the past.

MS. FOX. But the price they pay for being too big to fail is that the stodgy old regulator is back.

MR. VOLCKER. The regulator is certainly back, and it's just a question with what force the regulator comes back. We may be headed for a system where—it would work for a while, but not permanently—the big banks are back, they're fully protected, but they're prevented from doing anything very exciting. That will make them unhappy. They would become like a public utility, and the regulators would say, "If you want to be reckless or imaginative, you go create a hedge fund, but don't do it in a bank." For a while, the banks would be happy enough, because they would be getting enough business to make them happy. But if they sit there five years from now and can't do exotic things, they're going to be very unhappy.

MR. SMALL. But why don't the boards of directors take more punitive action against some of the officers?

MR. VOLCKER. They were weak. They want to be happy. They want to go along.

MR. SMALL. But aren't there some governance issues here about board of directors and their responsibility to stockholders?

MR. VOLCKER. There are governance issues all right, but I don't think those conceptual issues override the human instinct not to rock the boat and to pay our guy as much as we can. He's our buddy. We don't want to get in a squabble. The only thing that will worry a board of directors is if it gets so flagrant they're afraid of a lawsuit. They do begin to get afraid of lawsuits, but they hardly know what's going on. The managers themselves are not very clear about what's going on. The poor board hasn't got the faintest idea.

MR. SMALL. Is it only under a cease-and-desist order that the Federal Reserve Board can get in and actually do something?

MR. VOLCKER. No. The Federal Reserve could go in. I'm sure there has been some, but whether it's enough, I'm not sure. This began under my time, but probably not regularized. If you're really seriously worried about what a big bank is doing, the president of the Federal Reserve Bank ought to go with the examiner to emphasize the importance.

I think for most bank boards—now, certainly, but even then—if the Federal Reserve or another regulator went into the bank with a shotgun and said, “We're not going to issue a cease-and-desist order against you, but you have to improve this or do this or that, or we will next year.” Certainly in today's circumstances, that would be very powerful.

As an observation, when I was a director at Bankers Trust, it was very proud of its risk-management system, I thought with some justice. In the first examination when I was on the board, the Reserve Bank regulators addressed the board—the Reserve Bank president didn't come for whatever reason. Maybe he didn't consider it serious enough. But they were pretty critical about some of the problems in the risk-management system. That was an eye-opener to the board. The regulators said you really should do this, that, and the other thing. There was no question in the minds of the board of directors that those things were going to be done. It was

just an instinctive reaction. When the regulators came back the next year, they said, “Good. You fixed it all up.” A few months later, the bank was in big trouble as a result of the Asian crisis, but it didn’t go bust.

MS. FOX. In your era, and the years following, when all the banks were having trouble, there were great debates about examination reports and how private they should be. All the regulators carefully protected examination reports. They weren’t going to share the reports. They weren’t going to give public seals of approval or disapproval. We don’t want to risk confidence. It’s all got to be done behind the scenes. With the banks guaranteed, basically, that argument goes away.

MR. VOLCKER. Maybe so. I agreed with that argument, but I think there’s something to what you say. If they’re a public utility, they ought to be treated that way. Maybe you don’t have to have all the secret hocus-pocus.

MS. FOX. Then there’s a lot more pressure on the regulators. If the regulators’ work is going to be public, it’s a whole different deal.

MR. VOLCKER. See, that may go so far. I don’t know how all this is going to work out.

MS. FOX. But you’re thinking about it, we know that.

MR. VOLCKER. It’s a mess. I have to write a report about it. I promised a report.¹²⁰

MR. SMALL. I bet you’re going to wait until the last minute, until you’re right up against wall—we’ve learned that about you.

MR. VOLCKER. The op-ed piece that I stuck in the *Wall Street Journal* I wrote in 15 minutes before 5:00 in the afternoon.

¹²⁰ See Working Group on Financial Reform (2009).

MS. FOX. Because you waited till the last minute to do it.

MR. VOLCKER. I probably wrote it at noontime and revised it and then called them up [at] 5:00 and said, "Would you like to have this?" I'm glad they did, because the Federal Reserve acted that weekend, so I got this in before it acted.

December 29, 2009 (Seventh Day of Interview)

MR. SMALL. This is Dave Small. Today is December 29, 2009. We are in New York City at the offices of Paul Volcker. I'm accompanied by Jeff Ernsthausen, who was at the Board and now is at the New York Fed.

International Monetary Policy after the Demise of the Bretton Woods Agreement

MR. SMALL. I reviewed what we covered in previous interviews, and one topic we might pick up on is international developments and the value of the dollar. We talked a lot about those developments—Bretton Woods, going off gold, and flexible exchange rates—during your years at the Treasury, but not so much when you were at the New York Fed and at the Board.

Let me start with a simple question. Someone could say: "We have gone off gold and we have flexible exchange rates, so there's not much left for monetary policy to do regarding exchange rates. Let the markets handle them." Once we entered flexible exchange rates, what were the issues? What were the big camps or competing paradigms that policymakers debated and disagreed about?

MR. VOLCKER. Well, the competing paradigms at the extreme were pretty clear. There was a great debate—in the late 1960s, I guess—between Bob Roosa and Milton Friedman in which the two opposing philosophical points of view were set out. Milton Friedman was arguing that floating exchange rates would take care of everything—exchange rates would move in a very orderly way, and monetary policy wouldn't have to worry about exchange rates, because they would smoothly adjust to differences in economic circumstances or monetary policy. At that time, I thought Friedman's view was probably more clearly articulated than Roosa's, but Roosa was, at that point, a fixed-exchange-rate guy. We were still on gold, and Roosa was defending the existing policy of maintaining the parity of the dollar with gold and the

policy that other countries would adjust off the dollar if they adjusted at all, but he thought you could get a little more flexibility in the system than what we had at that time, but not much.

I was brought up in the Roosa school. My concern was that while I thought we had to get the exchange rate changed and we had to go through some period of floating (I'm now skipping ahead a year or two), our experience with floating rates in the past had shown, and the future potentially would show, that they were quite unstable and disturbing, in terms of trade and monetary policy. Well, it turned out they were pretty unstable. But other than the recurring ups and downs from 1971 to the later 1970s, I don't remember specific instances standing out very much.

The crisis came in 1978, when the dollar was quite weak and we were in the midst of this inflationary process. The economy wasn't doing very well. The Administration got very concerned about the dollar, and the markets were concerned about the dollar. The Carter Administration put together—it was largely a Treasury initiative—a big rescue effort in October or November of 1978, which really took some new initiatives. That was the first time, I think, apart from swaps, when we borrowed in foreign currencies. And we raised the discount rate. I was president of the New York Fed at that time and the Treasury was in the lead, but I was in sympathy with what they were doing.¹²¹ The New York Reserve Bank took the lead in asking for an increase in the discount rate as part of the planned program. We borrowed foreign currencies. We intervened in the market heavily.

In the background, there was a lot of discussion about using a so-called substitution account with SDRs—parking excess dollar holdings in an SDR account. That was not actually proposed but was being pretty actively debated within the Treasury at the time. Interestingly

¹²¹ See Volcker and Gyohten (1992, p. 149–50).

enough, recently that idea has reemerged with the Chinese—how many years later? The Treasury was pretty far advanced in their thinking, but it never got to the point of international negotiation.

Anyway, that Carter Administration initiative to stabilize the dollar was a big effort, which was not entirely successful. It reassured the market for a while, as I remember, but exchange markets remained very uncertain into 1979. That was all a contributing factor in the malaise and uncertainty that were surrounding the economy and surrounding financial markets at the time I became Chairman.

MR. SMALL. You have, in the chronology in your book, that on November 1, 1978, the United States tightened policy and put together a package to support the dollar, but then, on December 17, OPEC nations start raising oil prices with the Iranian revolution.

MR. VOLCKER. Yes, I'd forgotten about that. This was in 1979?

MR. SMALL. Very late 1978.

MR. VOLCKER. 1978, yes. That would have been the second oil price increase and the beginning of the second oil crisis. You go back after we floated, back in 1973, and the dollar was weak. The weak dollar helped precipitate, certainly, the first oil crisis. But there were some other factors in there—I think some political factors in there—with Israel or something. There was a very strong inflationary movement, particularly in commodity markets, in the early 1970s. The wholesale price index was going through the roof at one point. It was a very disturbed period in terms of commodity prices and inflation generally. I don't remember exactly when OPEC began raising the oil price.

MR. SMALL. October 1973 was the first major—

MR. VOLCKER. October 1973. The effect of the oil crisis was rather limited, and then the increase in inflation became general, as I recall, probably in 1973. There was a lot of movement in exchange rates up and down, and the inflationary process really got pretty well started then. Then we had a big recession.

MR. SMALL. There's a sequence of events that people put together: lax monetary and fiscal policy, Bretton Woods collapses, the dollar falls, and then OPEC says, "We're pegging oil prices to the dollar." It wasn't just out of the blue that they raised oil prices. It was partly that they were taking a hit.

MR. VOLCKER. I may be wrong, but I think there was some political factor involved as well. But that sequence you describe, yes, is a commonly accepted version.

MR. SMALL. There also was President Carter's decontrol of oil prices as part of a negotiation with West Germany. Apparently, the Germans had been, were, and continued to be furious with the United States.

MR. VOLCKER. That was in 1978, I think, 1977 and 1978. In those days, there was still thought to be a certain amount of substance around G-5 meetings. This was a big negotiation. I must have been at the Federal Reserve Bank of New York. I was not in Washington. But I think it was in 1977 or 1978. The deal was that the United States would remove its controls on oil prices and the Germans would ease. Schmidt was the German chancellor at the time, and he always regretted that he made that agreement. He blamed a lot of the subsequent difficulties on the fact that he gave in to the Americans, made that deal—biggest mistake he ever made. But that was much later in the 1970s, and that was the last time, I think, a real binding agreement was made by the G-5, G-7, or whatever.

MR. SMALL. Putting together two pieces of the story: Earlier in these interviews, you recollected the story that, in late 1979, when you were going over to Europe right before the announcing of the new operating procedures, Chancellor Schmidt was furious with the United States.

MR. VOLCKER. Yes. I'm sure that colored his view, no doubt about that.

MR. SMALL. So let me just ask one general question about your view of Bretton Woods: Was it a way to impose discipline on domestic monetary and fiscal policy, in that the only way to keep exchange rates stable would be through disciplined monetary and fiscal policy?

MR. VOLCKER. Well, the fact of the matter is, whether you're under the Bretton Woods system or after we floated, international monetary developments didn't have much effect on domestic monetary policy in either case—certainly, when Burns was Chairman of the Fed. He was very easy, I think, during the breakdown of Bretton Woods, and he remained so after the breakdown of Bretton Woods. I can't remember any incident during that period when the Federal Reserve, after the floating, either tightened or eased monetary policy in response to being influenced by the exchange rate until 1978. At that point, policy was tightened because of the sense of crisis in the exchange market. That was overt and very clear. There may have been some, but I don't remember any even modest changes in monetary policy in response to exchange rate developments earlier—even, for that matter, in that early 1970s period, 1973, 1974, whenever it was, when the inflation rate was going through the roof. Policy eventually responded to the inflation rate, although probably not forcefully enough. Policy did something, but it wasn't anything to do with the exchange rate, as best I remember it now. I'm fuzzy on the exchange rate during that period. It had its ups and downs, which has continued to this day.

MR. SMALL. Right before you became Chairman, the dollar was under attack. Inflation was headed up. I take it that the attack on the dollar was seen as all that more of an indication that inflation was getting out of control. The Board needed to—

MR. VOLCKER. I think the main focus was on domestic inflation. The exchange rate uncertainty certainly would have reinforced it.

MR. SMALL. Then interest rates rose significantly, so the dollar strengthened. And you had an Administration that was saying, “Let’s not intervene.”

MR. VOLCKER. Just to be clear, before Reagan became President in 1981, during the previous Democratic Administration, William Miller as Secretary of the Treasury bought a lot of foreign currencies as the dollar went up, which was a good thing—certainly reasonable. The Treasury was not averse to intervening at all. Neither was I. So we stocked up on some foreign currencies.

Then the new Reagan Administration came in and said, “No, no, we’re free traders, we don’t want to do that anymore.” They made a great point in saying they weren’t going to intervene except in very exceptional circumstances. When President Reagan got shot, they agreed to intervene in the market that day or the next day, in case the market had a disproportionate reaction to the assassination attempt. So they said, “See, we’re not absolutely rigid.” The intervention didn’t amount to much, but that was the only time they were really willing to intervene. And the dollar got stronger and stronger. I thought we should have been buying foreign currencies, but Treasury wasn’t willing, and I wasn’t going to make a big public fight about it. I had other fish to fry.

MR. SMALL. But then you enter the second term of Reagan, and you have a switch between the Chief of Staff and the Secretary of the Treasury. That was in early 1985, and by the fall of 1985 you have the Plaza Accord.¹²²

MR. VOLCKER. Jim Baker came to the Treasury. He was obviously much more sympathetic toward my concern about the exchange rate and what to do to influence it. He thought that was an important part of the responsibilities of the Secretary of the Treasury. At that point, Baker had a deputy secretary—Richard Darman—who wanted to get involved in this interesting international aspect of the Secretary of the Treasury’s responsibility. So they were interested in the exchange market from the beginning in a way that Donald Regan was not—Regan’s people, that is.

By then, the dollar had risen—perhaps too much. I think what tipped off the early intervention was excitement about the British pound getting so weak. I wasn’t there, but presumably Prime Minister Thatcher called Reagan and said, “Please do something, Ronnie.” Reagan spoke to Jim Baker, so we had some intervention to lower the dollar for the first time in a long time—January, February of 1985. At the time, the Germans were generally anti-intervention, but at the time of the IMF meeting, it must have been in 1984, they got concerned enough so that they intervened in a big way. We refused to join them, which I thought was a big mistake to take this rigid line. I guess, after a while, the Germans desisted.

But we didn’t do anything until the following January or February of 1985. There may have been a peak in the value of the dollar in February, and then it went down some, but it began

¹²² “September 22 [1985]: The Group of Five finance ministers meets at the Plaza Hotel in New York City at Secretary Baker’s invitation. The G-5 issues its first public statement, secretly negotiated over the previous three months, declaring that the dollar is too strong and no longer reflects ‘fundamental economic conditions’ and calling for ‘orderly appreciation’ of other currencies against the dollar. The United States agrees to take part in coordinated exchange market intervention” (Volcker and Gyohten, 1992, p. 357).

going up again at some point in the summer.¹²³ There was a lot of concern in August that the decline in the dollar was over and might reverse itself. I remember going over these statistics with you before. It doesn't show very clearly in the statistics, but the concern was certainly there. That's what got Baker off on the Plaza idea.

MR. SMALL. Month average—August to September, the dollar did strengthen a little bit.

MR. VOLCKER. I guess it wasn't very much, just a little bit. But it certainly seemed a change in the direction from the decline that it had before. Baker was very unsure about the political pressures of protectionism which were being stoked by the extreme strength of the dollar. Baker and Darman had been attracted to the idea of target zones for the exchange rate or whatever they were, ranges, whatever. They were playing around with this idea. It didn't originate with them; I remember Roosa was pushing it around that time and earlier. The Treasury became quite attracted to that idea, which I was not at all opposed to. But the idea of the Plaza Agreement was consistent with the idea that exchange rates could or should be controlled or influenced within some wide band. But they had to get them down in the first place.

I don't know when Jim Baker first began thinking about this. Some weeks before Plaza, we had a lot of conversations about the strength of the dollar and what we could do. I was concerned that the Treasury was too eager to push it down too far and too fast, and it would get out of control. We had a lot of discussion about how to maintain some reasonable control on the way down.

¹²³ "February 26 [1985]: After coordinated intervention by the G-10 led by the Bundesbank and estimated at \$10 billion, the dollar peaks at 263.65 yen and 3.469 deutsche marks and starts falling" (Volcker and Gyohten, 1992, p. 356).

MR. SMALL. You had fought this great battle against inflation, and you wanted to lock in the credibility gains and the credibility of the Fed. So if you then embarked on a weaker dollar strategy, a lot of that gain could have been lost?

MR. VOLCKER. Well, not the dollar. I was worried that—

MR. SMALL. You were nodding “yes” to that?

MR. VOLCKER. “Yes” in general. But I was concerned that, here we were, the world currency and so forth, and it was rather unusual to be knocking down your own currency deliberately. The dollar had gotten very high, there was no question about that. But I didn’t want the decline to get out of hand and snowball and become uncontrollable on the low side and undercut inflation and credibility and all the rest. That was my concern.

I didn’t want to aggressively push it. I thought once we announced what came to be the Plaza Accord, it would go down by itself, which it did. There was intervention at the beginning, but there was very little intervention in the end, because the market went down by itself. Baker was proud, saying, “Let’s push it some more.” And I would say, “No, let’s go slow,” which you then saw reflected here in these charts in early 1986.

MR. SMALL. So coming out of the Plaza Accord in 1985, how would you describe how you and Baker came out?

MR. VOLCKER. I thought the dollar was too high.

MR. SMALL. So there was no real tension?

MR. VOLCKER. I thought it had been too high for a long time. I think I welcomed the idea that he was concerned about the exchange rates and willing to intervene. I just didn’t want it to get out of hand.

MR. SMALL. A few months later, in January—

MR. VOLCKER. Enough is enough, exactly. We went through a long waltz. I'd go up to Capitol Hill and testify and say, "Well, I think the dollar is down far enough. I don't want a weaker dollar." Baker would go up the next day and say, "Yes, let it go down some more." We never had a big fight about it, personally. From my point of view, it came out okay, because my testimony or press conference or whatever would always be, "Let's be cautious and stabilize," and his would be, "Let's make it weaker." It came out okay. Didn't go down, didn't go up, as I remember.

MR. SMALL. But the press played it up a bit.

MR. VOLCKER. Naturally. I'd forgotten that it got played up that clearly in the press, as this article here on a G-5 meeting in London indicates.¹²⁴ But I think this went on for months. This was just the beginning.

MR. SMALL. Do you remember that G-5 meeting with finance ministers in early 1986 in London?

MR. VOLCKER. Well, the finance ministers and central bankers met together. I don't know if I knew this at the time, but the finance ministers had gone off and had dinner the night before. They produced this communiqué which didn't say it bluntly but had some language that said, "look forward to further declines in interest rates." Whatever it said, I said, "No, I don't want to be committed to the language." Karl Otto Pöhl said he didn't want to be committed to that language.¹²⁵ So they dropped it.

MR. SMALL. So was there a bit of tension between the finance ministers and the central bankers?

¹²⁴ See Rowan (1986).

¹²⁵ Karl Otto Pöhl was president of the German Bundesbank from 1980 to 1991.

MR. VOLCKER. Yes, there's no question. I don't know how united the finance ministers were. The only central bankers who made any difference were from the United States and Germany. Who else was there? The French. I don't know what position the French had then. But it was basically that, since neither I nor the Germans were willing to move and didn't want the "look forward to further declines in interest rates" language, the finance ministers had to take it out.

Chairman Volcker Outvoted on the Discount Rate: February 24, 1986

MR. SMALL. I want to bring you through this period, but I'm peeking ahead a month or two, and there's a revolt coming at the Board—the February 24 discount rate vote.¹²⁶ You come back from London, and the press was playing up differences between you and Baker.

MR. VOLCKER. I was trying to get the Germans to move all through this period, because the European economy didn't look very strong to me. I thought it was important to get the Europeans to move—maybe the Japanese too, I don't remember. But, particularly in retrospect, I had been pretty outrageous in yelling at the Bundesbank in private.

MR. SMALL. You thought they had economic slack?

MR. VOLCKER. Yes, I thought they ought to move, but it was also in my interest, because I wanted to take the downward pressure off the dollar to the extent there was any. The last thing I wanted to do was lead alone a parade of reductions in interest rates. The Germans didn't want to move—they resisted.

¹²⁶ On February 24, 1986, Governors Angell, Johnson, and Seger and Vice Chairman Martin outvoted Chairman Volcker and two other Governors 4–3 over the issue of the discount rate—the four were in favor of cutting the discount rate. That action was reversed on the same day with an agreement that a discount rate cut would be postponed while Volcker negotiated with the West German and Japanese central banks to enact similar cuts.

But then, when it seemed clear the United States was going to move one way or the other in time, I made phone calls to Shijuro Ogata and Pöhl the next morning. I said that we better coordinate a reduction in interest rates, and they both agreed relatively quickly.

MR. SMALL. But leading up to that, before that discount rate vote, you were talking with the Germans. In early February, you get two new Board members who were Reagan appointees. Before that, were you involving the whole Board in your efforts and discussions concerning the value of the dollar?

MR. VOLCKER. I probably was not. I don't remember how much. There was some loss of mutual trust. It's clear from the conversation with the Board at that discount rate meeting that I was making my position clear, that I thought the Germans ought to move. But I can't remember how much discussion we had of that in the Board. Who were the Governors that were left? The two new ones were Johnson and Angell, right?

MR. SMALL. Yes.

MR. VOLCKER. And Martha Seger was already on the Board.

MR. SMALL. Yes. Just to back up a little bit: During your term as Chairman, first Phil Coldwell left early in February of 1980, replaced by Lyle Gramley.

MR. VOLCKER. Then Schultz left and was replaced by Preston Martin. Schultz left when?

MR. SMALL. February of 1982.

MR. VOLCKER. So he was there two and a half years when I was Chairman.

MR. SMALL. Schultz was replaced pretty quickly by Preston Martin. Then you went two years with that Board until June of 1984, when Nancy Teeters left and Martha Seger came on. That's the summer of 1984.

Then, in the fall of 1985, Lyle Gramley left, and then, early 1986, Chuck Partee left. Wayne Angell and Johnson came onto the Board in early 1986.

MR. VOLCKER. It was Gramley leaving that really screwed things up. [Laughter]

MR. SMALL. So, to back up a bit, people might think of you as the CEO of the Federal Reserve, the Chairman generically being the CEO, and getting a heavy influence in appointing Board members. But you don't have any statutory authority to do so. At times you get appointments you like, at other times you don't. How does that work?

MR. VOLCKER. Well, it depends upon what the Chairman's relationship is with the Secretary of the Treasury and the Administration, I guess. Lyle Gramley wanted to become a Board member. I forget whether I had another candidate at that time. But Gramley, I knew. He was perfectly acceptable to me. They asked me whether he was acceptable.

MR. SMALL. The Carter Administration asked you?

MR. VOLCKER. Yes. They had cooperated. They hadn't complained about policy. So I wasn't going to say "no." I may have had another candidate in mind, I don't remember. But I certainly had another candidate in mind when Schultz left.

MR. SMALL. He left because he didn't get reappointed?

MR. VOLCKER. Yes, it was the end of his term as Governor. He was a Democrat and had a political background and so forth, and the new Administration would have definitely wanted to appoint their own person. He was a big loss, because he was terrific. I knew Preston Martin from his days at the Federal Home Loan Bank Board, and so I had no particular problem with him as it turned out. I might have been able to block it, I don't know. But I had no interest, no particular reason to block it at that time.

MR. SMALL. What about working with him?

MR. VOLCKER. Well, it turned out that he was not “cooperatively loyal,” let’s put it that way. Initially, he was okay. But then Nancy Teeters left. The Administration wanted to replace her with another woman. I think there was a vacancy for a long period of time. They looked and looked and looked for a woman. I think I had suggested some women, but it didn’t work out for some reason or another. I think a couple of the women that we talked about then later did come on the Board—much later. But then Martha Seger was recommended by Paul McCracken, who I thought was a sensible person. She had bank supervisory experience, which was a plus for me. I thought, “Great, we’ll have somebody with supervisory experience on the Board.” I never talked to her before she was appointed. Preston Martin had talked to her, and he was all enthusiastic—approving, anyway. So I thought she was a net plus. We had problems later, but I had no problem with the appointment.

In any event, there was a problem with Wayne Angell. He was a director of the Kansas City Reserve Bank. The Kansas City people were enthusiastic. They said, “He’s unorthodox in some ways; he’s got ideas, he’s enthusiastic. You’ll like him. He loves the Federal Reserve.” I had nothing to do with his appointment. Obviously, Senator Dole of Kansas was his big sponsor. Dole was the majority leader in the U.S. Senate at the time, I guess.

I wish this never happened, but a problem arose when Board supervisory people came to me and said they were thinking of issuing a cease-and-desist order on a small bank in Kansas that Wayne Angell was involved in personally: “How would that look when he was appointed as a Governor of the Federal Reserve and his bank had a cease-and-desist order?” I didn’t know what to do. I didn’t do it directly, but I got a message to the chief ethics guy in the White House—it may have been the counsel—saying, “Do what you want to do, but I’m warning you that there’s a potential problem here.”

This quickly got to Senator Dole and was interpreted as me trying to undercut Wayne's appointment. I'm sure it got back to Wayne. I'm not sure he ever knew the seriousness of the possibility of a cease-and-desist order, but he was bound to be a little upset.

MR. SMALL. Did you two ever talk about this?

MR. VOLCKER. I don't think so. I think we may have later, but we didn't at the time. He may have had a wounded feeling. We never had a cease-and-desist order against his bank. I don't know what happened.

MR. SMALL. Going to the week before the discount rate vote, what was the lay of the land, in terms of your relationship with the Governors?

MR. VOLCKER. Well, for the two new ones, it was nonexistent; they were brand new. The relationship with Governor Seger was not very good. She had connections in the White House, I'm sure. It's not unprecedented in the Federal Reserve, but it was not very comfortable for the Chairman, and she vocally and otherwise bristled at the bureaucratic procedures and restraints at the Board generally. But before then, Preston Martin had become much more aggressive and outspoken, making a lot of speeches and acting most peculiarly, from my standpoint, in the Federal Open Market Committee meetings. He'd seem to agree upon some approach and then take another approach when he got to the meeting. He had made a speech undercutting the debt strategy for dealing with the Latin American debt crisis when I was in Japan.¹²⁷ I got irritated. I should have. He was out of bounds, and he had promised me not to speak about it. So it was an accumulation of unhappiness.

¹²⁷ In June 1985, the Vice Chairman made public comments about easing the debt burdens on Latin countries that created an impression abroad that American policy was about to change. In a rare public rebuke, Chairman Volcker (1985), who was in Japan at the time of the Vice Chair's comment, offered the following response: "I find his reported comments incomprehensible, and unfortunately and unrealistically suggesting that there are unorthodox approaches to deal with the international debt problem. What is hopeful and promising is that so many countries are coming to grips with necessary and difficult adjustment efforts. One example is the highly promising effort currently underway in Argentina." [For newspaper coverage of the event,] see Bennett (1985) and Swardson (1985).

But during this period leading up to the vote, the idea of reducing the discount rate became less and less likely. There was quite a lot of pressure to do it a month or two earlier, but the economy did better than people were expecting, so that pressure disappeared.

MR. SMALL. So the requests from the Reserve Banks for cuts in the discount rate started declining?

MR. VOLCKER. Yes. This vote on the discount rate was a desperate move, because I think we were down to just one Reserve Bank proposing it. If you had no Reserve Bank proposing it, you couldn't do it anyway. It would have to be a Board decision to change the discount rate.

MR. SMALL. How important, in the scheme of things, was that discount rate vote? Did it reveal to you difficulties of working with the Board?

MR. VOLCKER. Absolutely.

MR. SMALL. Did it take some of the shine off of coming into work every day?

MR. VOLCKER. Yes, absolutely.

MR. SMALL. Did you see it coming?

MR. VOLCKER. No, I didn't see it coming that day. I knew that a Monday was not a time when—given the kind of established procedures at the Board—you would make policy decisions. The Board met on Monday and Thursday, I think. This was a Monday, and Monday was always a routine informational session—not one with policy decisionmaking discussions.

MR. SMALL. The staff was giving their presentations.

MR. VOLCKER. [The] staff gave their reports. You had a little discussion about monetary policy, but those meetings on Monday never were policy decisionmaking meetings.

Then, all of a sudden, unsuspecting, on that Monday, why did this come up then? If we were going to discuss this kind of thing, it would have been on a Thursday.

MR. SMALL. But Wayne and Manley might not have been aware of all the cultural aspects of the Board. But you think maybe Preston Martin and Seger—

MR. VOLCKER. I think that is true. Seger wouldn't have cared. Angell and Johnson were brand new. The idea that this was a Monday, not a Thursday, probably didn't occur to them.

MR. SMALL. Press reports at the time draw a picture of Jim Baker in the background pushing. Did you get a sense of this as a Baker initiative?

MR. VOLCKER. Well, I wondered. I think this is public, so I don't think I'm revealing anything.¹²⁸ When Johnson became Governor, he came to see me and said, "I promised Baker the first chance I get, I'll vote for easy money; I'm committed to him. But after that I'm going to be a good Governor." So this was the first chance he got. So, in a sense, he was just carrying out his agreement with Baker. Baker, I assume, sort of said to Johnson, "If I appoint you, you're going to vote for easy money the first chance you get." Angell was probably a little sore about this other thing, so he probably wasn't inclined to be particularly sympathetic toward me. Seger was certainly not sympathetic. Martin wanted to become Chairman, I guess.

MR. SMALL. People have inferred that this affected your desire to be reappointed for a third term. Bob Woodward makes the claim that Baker was going to make it very clear to you that, through forthcoming appointments, the Board would be drifting away from you, and this was a strategy for Baker.

¹²⁸ See Woodward (2000, p. 18).

MR. VOLCKER. I don't know what Woodward said, but I have no doubt that the ideal outcome from Baker's standpoint was to have me as Chairman and to surround me with his acolytes. No question in my mind.

MR. SMALL. Because he needed Paul Volcker for the credibility against inflation and as the tough guy, and that way he could actually have a little easier monetary policy and still have credibility?

MR. VOLCKER. That is correct, in my perception.

MR. SMALL. I'm making things up, but if Baker had the credibility of Paul Volcker to reassure markets, then he could actually run a little looser monetary policy, in fact, because the—

MR. VOLCKER. I don't know all he had in mind. But I had no doubt in my mind that Baker wanted to surround me with his appointees.

But, from the standpoint of my leaving, it delayed things, because once I, in one sense, "won," Martin had to resign. By that time, the Board members would all be coming up—not all of them, but Johnson and Angell affirming to be loyal. I couldn't resign. Martin resigned whenever it was—in April. I couldn't resign in June or September. Then Irangate came along, and I perceived that as a political problem, and Reagan didn't need me resigning in the middle of Irangate. So then it got into 1987. Why am I resigning four months before the term is up, anyway? So the time to resign was in 1986, but that couldn't happen because of the circumstances.

MR. SMALL. Aside from votes on the FOMC or discount rate votes, what about your working relationships when a Henry Wallich or a Lyle Gramley left? Was there a sense that you had fewer people to brainstorm with?

MR. VOLCKER. There's no question that some of these people I had known for years and worked very closely with them. You get a new group coming in, at least one of which was antagonistic. Johnson and Angell weren't really antagonistic. And Heller and Kelley were the next appointments, I guess, and they certainly were fine, but they were not old friends of mine.

Board Committees

MR. SMALL. How does trust or lack of trust affect the operations of the Board? For example, you have someone vote against you—I'll mention Wayne Angell as an example. Then, in a separate sphere, you need to appoint someone to head up consumer affairs or the budget committee. I think Governor Angell oversaw Reserve Bank budgets.

MR. VOLCKER. Yes, I think Angell did. Well, there might be some subtle interplay.

MR. SMALL. Did you get involved in those various committees?

MR. VOLCKER. Well, the most active committee was the oversight of the Reserve Banks. It was the most difficult one. That was actually a responsibility, because whoever headed it had to deal with the Reserve Bank boards and the Banks' presidents and exert whatever discipline existed on salaries and other things. So it was potentially contentious and difficult and substantive. The other ones depended on circumstances. But I was more interested in the regulatory side than anybody else. So Partee, I guess, was the regulatory Governor for a while. He didn't do much that I wasn't also involved in. The same thing internationally—Wallich was very well known internationally. The most important stuff I was dealing with directly. Consumer affairs, you had to make sure somebody was paying attention to it.

Board's Responsibility for Consumer Affairs

MR. SMALL. What gets a lot of attention now is the Board's oversight—or, some people claim, lack thereof—with respect to consumer affairs and the Board's delegated

rulemaking authority. What was your view of that delegation? Was the Congress passing the buck by giving that responsibility to the Fed? Was this an area you didn't want to get involved in?

MR. VOLCKER. Well, that was always considered something of a sideshow, not directly so important to us. But since we were given the responsibility, I had a responsibility to do it as well as you could. In my experience, no Governor was particularly eager to be the chief honcho there. But I thought the guy after I left, Larry Lindsey, did a very good job and paid a lot of attention to it. I think Partee might have been the Governor at one point. He would have paid a good deal of attention to it. We tried to do a good job, but it wasn't considered the mainstream, for sure. I think the responsibility increased, I think, afterwards. There was a new law or something. Or maybe it was the Community Reinvestment Act, which was fairly new when I was there. We were just beginning to apply it? I don't quite remember.

Elections to the Board of Directors at the Reserve Banks

MR. SMALL. You talked about overseeing the Reserve Banks. Let's start at the perimeter of that, which maybe people don't understand very well. Each Reserve Bank has a board of directors, and the board of directors gets elected by commercial banks.

MR. VOLCKER. Six of the nine, yes.

MR. SMALL. Say, someone in a small rural town says, "I want to become a Reserve Bank director." Who votes? How do they run?

MR. VOLCKER. Well, it would vary from Reserve Bank to Reserve Bank. But, basically, the election by the banks tended to be pro forma. I think in most Reserve Banks—this is oversimplified—the President would get an idea of who would be a good director, and he

would inform the local banking association, or they'd have a conversation and say, "What about this guy, what about that guy?"

MR. SMALL. So this would be a good candidate for a Class A director, this would be a good candidate for a Class B, this for a Class C?

MR. VOLCKER. Right. Usually, I think, in New York's case, there was never any controversy. Occasionally, something would happen the way you described it. Somebody wanted to be on the board and lobbied the bankers or lobbied the Reserve Bank. Once in a great while, I guess, you had a contest. I think it was very, very rare, but I think you'll find some Reserve Bank someplace where, for some particular position, there was actually a contest.

MR. SMALL. How does it happen for the various classes of directors? Do the commercial banks vote?

MR. VOLCKER. In all the Reserve Bank Districts, the big banks had a director, the medium-size banks had one, and the small banks had one. I don't know who defined who was big, who was medium, who was small. But in the New York case, it was fairly clear. You had one of the big New York bankers on it. In those days, you say "regional" banks, and they were represented by having a Rochester banker or Buffalo banker or a New Jersey banker on it. Then you would have some country banker on it. That was just a pattern. I don't remember whether it was rigidly by size of the bank or what. But it was a quite distinct pattern. I think that was true of all Reserve Banks. They all had a big bank, small bank, medium-size bank. It was by law. The law may have said "representative of the banking community" or something like that.

You'd always try to get interested but prestigious local businessmen to be the Class B directors. There was a long tradition in the New York Reserve Bank. The head of General Electric was on the New York Bank board, which was not true when I was there, but it's true

now. They reverted to that tradition. Typically, with the Class C, the Board of Governors might have a candidate, but by and large, the Reserve Bank presidents would propose to the Board of Governors who they wanted as Class C director. There'd be some back-and-forth. By law, they were representative of the public interest, and the Reserve Bank would want influential leaders from the regional community.

Supervision and Regulation at the Board and Reserve Banks

MR. SMALL. Someone might say this doesn't, on the surface, look like a process whereby you'd get a real aggressive bank regulator on the board of a Reserve Bank.

MR. VOLCKER. That's true. But, technically, the Reserve Banks don't have the authority for bank regulation.

MR. SMALL. But it is delegated to them.

MR. VOLCKER. It's delegated from the Board of Governors to the extent they have it. And most decisions, I think, in which you have a cease-and-desist order or something, it has to go to the Board of Governors. But you're right, I guess you're right. Some of the Bank presidents were not interested in bank supervision, no question about that.

When I went to the Board, it depended upon the Bank. Some of the Reserve Bank presidents wanted to disassociate themselves from bank supervision and regulation. They may not have said that directly, but, in fact, they didn't want to mess around with this regulatory stuff. They wanted to be policy talkers and representatives, but they didn't like getting involved in banking supervision and regulation. It depended. Some did, some didn't. It was not uniform. Now, that changed when I was there, pretty much. I had some influence in insisting that they did get involved.

MR. SMALL. To think about accountability, suppose you have a commercial bank in trouble, and maybe it causes some systemic problems, and finally the problem is solved one way or the other. Let's say it's a bank that the Federal Reserve has supervisory power over. After the fact, who's held accountable for the initial problem? Is there accountability? Has a Reserve Bank president ever gotten called on the carpet after the fact and been told—

MR. VOLCKER. Not to my knowledge.

MR. SMALL. Some might say someone should be accountable at the end of the day for—

MR. VOLCKER. Well, I think accountability at the end rests with the Board of Governors and with the staff of the Board of Governors. Presumably, if you have a strong head of Banking Supervision and Regulation at the Board of Governors, he or she would have been alert to all that and would have had some idea—it varied a lot. Some Reserve Banks had some good people, interested people, good regulators, and some did not. I don't know what else I can say. There is no clear responsibility at the Board itself.

I proposed, and I will propose again, that somebody on the Board of Governors be held responsible, because although you had a Governor informally designated as your lookout for supervision and regulation, he or she never really felt fully responsible in the way that you're indicating.

MR. SMALL. You told the story in these interviews that when you became the president of the New York Federal Reserve Bank, early on, your staff came to you and said that you were going to have lunch with Citibank, and you found out that not a lot of substance—

MR. VOLCKER. From a supervisory standpoint, it was a nothing.

MR. SMALL. How about when a Reserve Bank president goes into a meeting with his or her board of directors. Are the meetings pro forma? Are they very formal, with accountability issues? What's the business end of those meetings?

MR. VOLCKER. I don't think they ever got into supervisory problems, because that would have been considered inappropriate: conflicts of interest and confidentiality problems. I don't think they ever got into discussion of particular banks. We went on a big campaign then to get capital requirements up, but I don't remember that particularly being discussed at the board, that kind of issue, when I was president of the Reserve Bank of New York.

What we did change—try to change, and probably continues now—is that if you had a problem in a bank, the president of the Reserve Bank ought to be the messenger to that bank, if it's a real problem. If it's an important bank and it had a problem, the Reserve Bank president should involve himself, which had not been any kind of a consistent pattern anywhere in the Federal Reserve Banks. I think that is a pattern now. They were pretty removed—some of them.

MR. SMALL. And maybe appropriately so, because the delegated authority came from the Board—

MR. VOLCKER. They historically felt they wouldn't address it; it leads to certain friction, anyway. But they might say, "Look, that's been delegated. These staff people that I have, I appoint them partly with the approval of the Board people; they're reporting to Washington, not to me."

In fact, they report to both places. Regional Reserve Banks don't have much responsibility for anything anymore, because everything's gotten centralized. But if they don't have responsibility for banking supervision, then what are they going to do? Is that a big loss or not?

MR. SMALL. You talked earlier regarding the Vice President Bush task force and the need to protect the Reserve Banks as the roots of the Federal Reserve System and the connection they give the Federal Reserve to their own Districts.

MR. VOLCKER. This issue is smack up against us right now. I've got to give a big speech on the Federal Reserve; I agreed to it. I had a delegation come to me saying, "Save the Federal Reserve, go save them." So I'll make a speech. I don't know if I can save them. But it's very awkward if you try to explain this organization to somebody. What is this? Directors elected by banks? Whether they're elected by the banks or not, what are these private people doing out there on the Reserve Bank boards? It's a very strange animal.

MR. SMALL. The banks own stock in the Federal Reserve.

MR. VOLCKER. Banks own stock. The guy in Kansas City, Tom Hoenig, recently made a speech. It was a good speech about defending the regional nature of the Federal Reserve. He put a lot of emphasis on this private participation; I'm not sure that's what we want to emphasize right now. So will you write the speech for me?

MR. SMALL. I'll clip out segments from these interviews. What I've learned from you is that the Reserve Banks and directors feed into and support the Fed's independence. The other thing I've learned is: "The thing that saves the Federal Reserve in the end is, the Congress doesn't want the Administration to have control of the Fed, the Administration doesn't want Congress to have control. And that, in the end, is what saves the Federal Reserve."

MR. VOLCKER. It is important, no question. Let me find something: "[What] seems to me beyond dispute . . . is that monetary policy and the structure and condition of the banking and financial system are intertwined. The reciprocal influences and interdependence make a compelling case that central banks have a strong voice and authority in regulatory and

supervisory matters. . . . [N]either monetary policy nor the financial system would be well served if a central bank loses interest in, or influence over, the structure and performance of the financial system.”¹²⁹ Who would you think wrote that in 1990?

MR. SMALL. A well-respected former central banker?

MR. VOLCKER. He also made a categorical distinction between banking and commerce and said the authorities have to strengthen bank capital and, when necessary, sack bank management. I don’t think I can improve on that language that I used in a speech 20 years ago.

You know what? There’s a possibility that what may come out of this current crisis is that the Federal Reserve will be the systemic overseer with a committee of other regulators, but the Federal Reserve is the chairman. But that may be all the Federal Reserve gets. This is what Paulson proposed two, three years ago. In that construct, I don’t know how to keep the Reserve Banks active in this area.

MR. SMALL. Well, one key question then becomes, what powers does the Chairman have over that if he’s just one of several equal votes?

MR. VOLCKER. Well, there’s no direct regulatory power; it’d just be oversight. Federal Reserve as a systemic regulator, as the Administration proposed, I think, is dead on arrival. The distinction they are making between a “systemic oversight” regulator and a regulator with the actual authority to send the troops out to regulate individual banks and supervise individual institutions, I think, is dead. That may be overstating it. But the Treasury proposed an arrangement of the sort that I am describing with themselves as chairman, Treasury as chairman. I think you can make a better argument for the Federal Reserve being chairman.

¹²⁹ See Volcker (1990, p. 15).

But it doesn't require all the troops out there supervising individual banks. It's a different kind of function.

Regulation in the Current Structure of Financial Markets and Institutions

MR. SMALL. I keep coming back to this thought that you expressed in your book about being at the London School of Economics, credit having escaped the banking system, and how that causes problems. So let me ask: It seems at least conceivable one could think of a problem in a large retail chain or some large company that issues, say, commercial paper, and that that problem frightens the commercial paper market—similar to the recent kind of problems when markets were freezing up. It seems you potentially could get very far into a financial problem without there being any identifiable large systemically important institution.

MR. VOLCKER. Systemically important ex post. [Laughter]

MR. SMALL. But you don't know who to point to, because it's a bunch of little people getting scared.

MR. VOLCKER. It is a problem that none of these proposals handles very well: What you do with the secondary repercussion, psychological flight? Now, what has been argued, which I would cling to—I'm not sure it's a very good argument—is that, in fact, during this recent severe crisis, there was not a run on the big banks protected by the safety net. There was a run on the investment banks, there was a run on other institutions, but not, in general, on commercial banks. It is, I think, broadly true. But there was no run on Citibank. There was a run, I guess, on one pretty big bank, but it was manageable. If that's generally true, build the firewall, so to speak, around the commercial banking system. If the rest of it goes bad, let it go bad.

MR. SMALL. Another way of stating it is, there was no run on an institution that had federal deposit insurance.

MR. VOLCKER. That's an exaggeration. Small banks had difficulties, and they could have had a run of creditors. Actually, the federal deposit insurance—I'm not sure where it stood, but finally, in the end, they said that all deposits would be insured.

MR. SMALL. Could you explain for our general audience why you say "commercial bank"? Because you're out in the press now saying, "Bring back Glass-Steagall—separation of investment and commercial banking."

MR. VOLCKER. Well, I don't say that. That's what I read in the press.

MR. SMALL. But you use the term "commercial banks." And they're distinct from investment banks and other financial institutions. I can take my money and put it in a bank and a day later cash a check against it. I can do that, at least with a big enough check, on my money fund. In your view, what is so important? What is a commercial bank in terms of function? Or is it just in terms of charter?

MR. VOLCKER. When I say "banks," I mean bank holding companies as well as banks; I don't make any distinction. There is no distinction to be made anymore, really. Banks are dealing with customers. They do some things of central importance, like manage the payment system. Your money market fund can provide a check, but that check is drawn on a bank. Banks are the place where small and medium-size businesses have to go for credit. It used to be big businesses went there. They still do. Banks still provide backup lines for big businesses and commercial credit. So banks still have a central role in the credit process and in the depository area and in the payment system. Those are functions that are central to the economy. If that breaks down, you really have got a problem.

What I will then call “capital markets,” they do a lot of trading, make a lot of money and so forth, contribute to the fluidity of markets and all the rest. But if one of them breaks down, even a big one, it doesn’t break down the whole financial system. The difference between even a Goldman Sachs going bust and a J.P. Morgan going bust is immense, even though the balance sheets may look the same in gross size. One is largely a trading operation—who cares if a trading operation breaks down? You care, but who cares that much? The individual institution is not central to the day-to-day operation of the system, but you do have to worry about contagion. The bank breaks down, things come to a halt.

MR. SMALL. One way to see this is that if an investment bank doesn’t hold a certain bond, someone else will, because it’s in an open market. But if a certain bank goes under and doesn’t provide credit to their local market—

MR. VOLCKER. There’s nobody else. That’s part of the argument I make.

MR. SMALL. Is it possible to separate credit extension from the payment system? Could you construct institutions that are involved just in the payment system?

MR. VOLCKER. Yes, that’s the original definition of a narrow bank. It can’t do anything but take deposits and invest in government securities and run the payment system. I’m a long, long ways from that. But you could hypothesize such a system.

Now, the other side—if money funds are going to provide that kind of service of payment on demand and at par, they should be in the banking system. The trouble is, I can’t get anybody to focus on that. I don’t focus on it myself, because I think it’s important but secondary. The Administration didn’t quite go as far as we went in our G-30 [Group of Thirty] report, but they said if you’re going to promise payment at par and immediately, you have got to be regulated—more strictly regulated than you have been in the past. I think that’s correct. The G-30 report

said that much, plus that money funds ought to have insurance fees. Money market funds have got to get insured like a bank and pay the insurance fee.

I don't really understand why money market funds exist now. I understand why they existed: They escaped Regulation Q and reserve requirements, and they escaped the insurance fee. These were big advantages. If you were an investment bank or something, it was convenient to have one. But why do banks have them now? I don't understand that, because what can a money market fund do that you can't do with a bank deposit?

MR. SMALL. With payment of interest on reserves, there's no reserve tax.

MR. VOLCKER. Can you pay interest on checking accounts now?

MR. SMALL. Not on business checking accounts.¹³⁰

MR. VOLCKER. It's a funny distinction: You can pay interest on individual checking accounts, but not on business checking accounts.

MR. SMALL. One issue is that many small businesses actually need that one-on-one relationship with their commercial bank, so the commercial bank can really get in and evaluate and see that they're a good investment risk.

MR. VOLCKER. One can take the other side: That function is less and less important. Small businesses now can use a credit card, and banks aren't the only suppliers of credit cards. You have these consumer loan companies—or whatever they're called—which make small business loans probably on easier terms than the banks do. So even in that area, banks aren't so central anymore. They certainly are weaker than they used to be.

¹³⁰ Before the enactment of the Dodd-Frank Act in 2010, depository institutions could pay interest on NOW (negotiable order of withdrawal) accounts—checking accounts that can be offered only to individuals, nonprofits, and governmental units. For-profit businesses could only hold checking accounts in the form of demand deposits, and Reg Q prohibited the payment of interest on demand deposits. They could engage in sweep agreements and thereby receive interest, or they could receive implicit interest in the form of earning credits, which could be used to offset charges for other services provided by the depository institution to the customer.

But the problem with this approach of having a systemic regulator is, you're going to end up regulating everybody and protecting everybody. This whole game is to limit the span of "too big to fail." Too-big-to-fail is okay for a few banks, but let's not extend the protection beyond banks and also let nonbanks get too big to fail.

MR. SMALL. But the definition of a commercial bank starts with, I guess, the definition of deposit on demand, is that right? Not the asset side so much, but the liability side?

MR. VOLCKER. The legal definition is, I think, you take deposits and make loans. I think the legal definition sometimes can come down to taking deposits.

MR. SMALL. That's where you would put, like the Group of Thirty [G-30], a first set of restrictions? If you take a deposit that's callable on demand, that opens you up to all kinds of runs, and therefore we're going to regulate it?

MR. VOLCKER. Yes. They've been regulated forever for good reason. Historically, people have felt the need to protect the banking system—arguably, for good reason. You're not going to take that away, I don't think. You may take away section 13(3) of the Federal Reserve Act, but you're not going to take away liquidity support. You're not going to take away deposit insurance. I'm going to win on this—that there is a distinction between a commercial banking organization that has direct access to the safety net and other financial institutions.

MR. SMALL. You're going to win? I think you were quoted at that *Wall Street Journal* conference as saying, "I think I might win."

MR. VOLCKER. I'm going to win, because, politically, it's a hard case to make that we're going to provide the same kind of support for Goldman Sachs, which is a big trading operation, as we're going to provide for a big commercial bank, or provide the same degree of

support for GE Capital, which is grafted onto a big commercial firm, as we're going to provide for commercial banks.

MR. SMALL. Let me quibble with that by saying—I think this is right—Goldman Sachs has relatively recently become a commercial bank.

MR. VOLCKER. They were made a commercial bank to bring them in the tent. But under my plan, they're going to have to give that up, or they can give up their trading, one or the other. They can either follow the rules of a commercial bank or give it up.

MR. SMALL. Let's say that we have a stalemate going forward on financial reform. Would you predict that, at some point, Goldman Sachs would revert back to being an investment bank—giving up being a commercial bank?

MR. VOLCKER. Oh, no. They've got the best of all worlds now. They can do what they want to do, and they can claim they're a bank.

MR. SMALL. Getting back to capital standards, you want to raise them. Could you explain why?

MR. VOLCKER. I want to raise capital, but I think there's too much emphasis on that. Not that it's a bad idea. But there's a limit how far you can go raising capital and leaving them commercially viable.

MR. SMALL. Maybe you could explain a little bit the concept behind the bank holding company, in terms of separating units within the holding company and setting up firewalls so that one unit doesn't drag down the other. Could you explain the concept and then the practice of that?

MR. VOLCKER. Well, I used to be a believer in that concept. I no longer am a believer since the Gramm-Leach-Bliley Act.

I don't think there's much distinction between the holding company and the bank. You try to put these firewalls up and stuff, but if a part of a holding company goes bad, the whole thing is going to go bankrupt if it is any substantial part. Suppose they had a big investment banking operation in a subsidiary of the holding company and had a big commercial bank in a different subsidiary of that bank holding company. If the investment company goes bad, almost by definition, the holding company is going to go bankrupt. If the holding company goes bankrupt, the commercial bank is going to go bankrupt. So I think we passed the day when that's a useful distinction.

MR. SMALL. Who are your comrades-in-arms with regard to the Adam Smith view you were describing in an earlier interview with us that maybe you can't regulate banks, so keep them small? I've heard in the press—I haven't read directly, but—that Alan Greenspan has expressed some sympathy, John Reed has expressed some. Is that gaining traction? Or is it just not going to be practical? For one, it's too expensive to go in and separate these units.

MR. VOLCKER. It's just that I'm such a mild-mannered, unimaginative person. I can't quite go in there and see how you're going to break these things up without an enormous brouhaha. I'd like to do things so they don't get any bigger. If you adopt my approach, the big ones will get smaller in balance sheet, because they couldn't do so much trading. We have a deposit limit now, and I certainly would keep that, maybe make it stronger.¹³¹ I certainly would discourage any further mergers among these big elephants. It's hard to imagine going backwards.

¹³¹ The restriction applied to interstate mergers and bank holding company acquisitions—the resulting institution could not control more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

MR. SMALL. The path forward might look a little scary if things keep getting bigger. Do you think international coordination on supervision is the answer, because it brings everyone in under these high standards? On the other hand, you could say it makes the institutions somewhat similar, and therefore any problems they do have tend to be shared in common. If we have one world order, then if there's a common flaw, we're really in trouble. Is it lucky that Japan didn't have a big financial sector with subprime mortgages at this point?

MR. VOLCKER. They didn't have it now because they had been in so much trouble earlier—that's one way to prevent it. I think you need to have a certain consistency internationally. If my approach is adopted in the United States, the screaming will be, "You can't do that to us, because we are chartered in the United States, and those guys in Europe aren't playing by that rule. They've got to be playing by the same rule." I think that is basically right. I think you have got to have roughly the same general framework, same accounting standards, same capital standards within limits.

MR. SMALL. Maybe we could break here.

March 24, 2010 (Eighth Day of Interview)

This interview is part of the Oral History Program of the Board of Governors of the Federal Reserve System. It took place on March 24, 2010, in New York City at the offices of Paul A. Volcker. Mr. Volcker was interviewed by Mr. David Small of the Board staff, with the assistance of Jeffery Ernsthausen of the staff of the Federal Reserve Bank of New York.

Mr. Volcker started the session by showing Mr. Small a passage from page 453 (footnote 316) of A History of the Federal Reserve, by Allan Meltzer.

Paul Volcker for Fed Chairmanship in 1965?

MR. SMALL. For the sake of the readers of this interview, I will quote this passage from Meltzer: “Earlier in the discussion [President] Johnson asked [Secretary of the Treasury] Fowler if he had thought about replacing Martin [as Chairman of the Federal Reserve]. Fowler told him that he had considered Paul Volcker, but he was unsure. [Fowler said,] ‘We want a sure vote, not a reasonable fellow who will try to steer us down the right path. We’ll just want a fellow that just goes along.’”¹³²

MR. VOLCKER. What’s the date of that?

MR. SMALL. November 28, 1965.¹³³

MR. VOLCKER. This would have come at the time of this fight over the discount rate increase that we’ve talked about. It would have been right after this meeting, I think, that the Quadriad had when Martin said he wanted to raise the discount rate.

MR. SMALL. Was that your memo with Okun, Brill—

¹³² See Meltzer (2009a, p. 453, note 316).

¹³³ William McChesney Martin was reappointed by President Johnson as Chairman of the Federal Reserve in March 1967.

MR. VOLCKER. This was the story: Fowler liked me. This is what's interesting about this. Fowler was recommending to Johnson that I become Chairman of the Federal Reserve Board. I knew that later, because it's in that biography of Martin.¹³⁴ I knew nothing about any of this at that time.

That is about the time when we had this Quadriad meeting where Fowler took me along to discuss the fact that the Federal Reserve wanted to raise the discount rate. President Johnson, I realize now, was more emotional than I thought at the time. He didn't like the idea of an increase in the discount rate, and finally Martin said—he was just sitting there listening—“Yes, Mr. President. I think I have to do this. We've got to do this.” When Johnson finally realized he wasn't going to get any further, he said, “You can't do this. I've got to go to the hospital to have my gall bladder taken out, Bill. You wouldn't do it when I'm in the hospital, would you?” Martin said, “No, Mr. President, we won't do it while you're in the hospital,” with the implication that “We'll do it when you get out of the hospital.” Martin did wait, and the Board raised the discount rate on December 3, 1965.

A day or two later, Martin was summoned to LBJ's ranch. Varying stories have been told how Johnson physically attacked Martin. Martin didn't say—to his colleagues, anyway—that he'd been physically attacked, and I don't know whether that the part of the story that he was kind of pushed against a wall is true, with Johnson saying, “How could you do this to me? You're destroying America,” and so forth.

But anyhow, my explanation for this conversation about me possibly being appointed as Chairman of the Fed by Johnson is that—I guess it's on tape—Fowler got along very well with

¹³⁴ Bremner (2004, p. 207) cites a November 3, 1965, memo from Secretary Fowler to President Johnson.

me. I got along very well with Fowler. He was a big supporter of mine. He later wanted me to become a partner and eventually take his place as partner at Goldman Sachs.

Anyway, whether he personally believed strongly that the discount rate should not be increased, Fowler was officially opposed to the discount rate increase—very forcibly. He kept arguing with Martin about it. I kept telling Fowler, “Why don’t you compromise?” Martin wanted to increase by $\frac{1}{2}$ percentage point, but I said, “Why don’t you compromise on $\frac{1}{4}$ percentage point?” [laughter], because I thought Martin was basically right. Then they had this group memorandum, which is what you’re thinking of.¹³⁵ They said, “Let the experts give us a recommendation in it.” It was very odd. I’m sure we talked about this earlier in these interviews. The Treasury was officially opposed to an increase in the discount rate, but I (a Treasury official) was in favor of it. Martin was in favor of an increase, but Dan Brill (the director of Research and Statistics at the Federal Reserve Board) thought a discount rate increase was a mistake. It was crazy. Anyhow, we produced that memo, which I’m not very proud of.

MR. SMALL. But you have your saving grace in the memo.

MR. VOLCKER. Yes, a small saving grace. [Laughter] In my mind, it was a bigger saving grace than it turned out to be. But it was there.

I can’t imagine that this young guy—basically, an assistant secretary position in the Treasury—would suddenly be made Chairman of the Federal Reserve Board in such controversial circumstances. [Laughter] I don’t know who was on the Board then. Guys like [J.L.] Robertson would have been outraged, I’m sure. If Dewey Daane was on the Board, he

¹³⁵ See Volcker and others (1965).

wouldn't know what to make of it. He was an old friend. I don't remember who else was on the Board then.

MR. SMALL. George Mitchell and probably Sherman Maisel.

MR. VOLCKER. Mitchell was on the Board. Sherman Maisel may have been.¹³⁶ I don't remember. But I sure wouldn't have been reappointed, because if Nixon won the presidential election, Burns was going to become Chairman. All I would have done would have been fighting with them for four years over making money tighter than it was. My career would have been ruined! [Laughter] At age 38, I would have been out of a job.

MR. SMALL. You would have been like Thomas McCabe, who had a short-lived chairmanship.

MR. VOLCKER. McCabe was Chairman for just under three years. I presumably would have served out the term. Or maybe I would have been so successful that Nixon wouldn't have been elected, and I could have been Chairman forever. [Laughter]

MR. SMALL. You talk about when you did become Chairman and the high interest rates and the pain they caused. You say that you could do it at that time, because the public understood the need for drastic medicine.

MR. VOLCKER. That's right.

MR. SMALL. Perhaps Burns just could not have done it, even if he had been so inclined. If you had been Chairman of the Fed in 1965, the political landscape and public acceptance of high interest rates would have been much different from what they were when you did become Chairman.

¹³⁶ Sherman Maisel was on the Board of Governors from April 1965 to May 1972.

MR. VOLCKER. Yes, but we were not talking about 20 percent interest rates back then—that wasn't in anybody's mind. This argument was over moving from, I don't know, 3½ to 4; maybe it was 4½ to 5. In any case, it wasn't out of bounds of anything that it'd been before.

The big mistake the Federal Reserve made, or Martin always thought, was later, when basically a deal was made that if Johnson eventually went along with the tax surcharge, the Federal Reserve would be circumspect in monetary policy. In retrospect, the economy was much stronger than anybody realized at the time. That's when the inflation began taking off.

MR. SMALL. One of the stories behind that is that, at the Board, that mistake really set back the econometric modeling efforts, because the models were just being built, and I guess the models were forecasting a significant impact from the tax increase. So following the tax increase, there would be room for an interest rate cut. And when that depressing effect of the tax increase did not materialize—

MR. VOLCKER. Was there an interest rate cut or just no increase?

MR. SMALL. I'm not sure. But the staff modeling folks were arguing that the tax effect would be large enough to have implications for monetary policy.

To jump ahead a bit, you were appointed Chairman by Jimmy Carter in the midst of great financial stress, inflation, and pressure on the dollar. The story is that Carter was told that he had to appoint Paul Volcker. Maybe other names were mentioned, but, basically, even those people said, "You've got to appoint Paul Volcker. He's the one who has the necessary credibility, fortitude, discipline." People now look at that period and say, "Yes, that makes sense. That is plausible." In part it's plausible now because you were so successful. But why were you such a

logical choice back then? What in your career had led you to be known as so staunch against inflation?

MR. VOLCKER. Those comments you're reporting don't seem quite right to me. I was a natural choice because I'd been an undersecretary of the Treasury, not just a deputy undersecretary, at a very important time. I was pretty well known as the undersecretary of the Treasury for monetary affairs, and in the financial community in particular. Then I was in New York as president of the Reserve Bank. Nothing special about that, but having been both in the Treasury in a prominent position and in the Federal Reserve Bank of New York, a prominent position in the Federal Reserve hierarchy, it wasn't unnatural that I was considered for the chairmanship of the Fed, unlike in 1965. [Laughter]

I don't remember any great groundswell for me at all. In fact, it all happened very suddenly, because there was no opening until just before Carter nominated me. Carter made this opening by moving Bill Miller from being Chairman of the Fed to being Treasury Secretary. Then Carter realized a few days later that he needed a new Chairman of the Fed. It all took place in a matter of a week or something. So it's not that there was long discussion and speculation about it. The story is that Carter went to David Rockefeller. I'm sure there was probing of David Rockefeller. In my mind, he would not have been a good choice, because he didn't have the right background or instincts for it, and certainly he recognized that.

But I don't have the impression that you described that I was considered the great man—I may have been considered the one with the right experience. I don't remember being considered the one with the right fortitude, particularly.

MR. SMALL. But certainly, if someone had said, "We need someone in quickly who's fully tooled up—"

MR. VOLCKER. Yes, there's no question about that.

MR. SMALL. I guess being president of the Federal Reserve Bank of New York is the most proximate job to being Chairman of the Fed.

MR. VOLCKER. At times, anyway. But what I'm smiling about, going back and forth here, is this conversation I knew nothing about as to whether I should become Chairman of the Federal Reserve in 1965. I then went back to Chase Manhattan in a secondary position. I mean, I wasn't becoming vice chairman or something of Chase Manhattan. [Laughter] I was in the upper-middle hierarchy, I would say. I was not in the senior hierarchy. I was more than the middle, but not the senior.

MR. SMALL. Well, President Johnson might have known that Martin came to be Chairman from the Treasury.

MR. VOLCKER. As assistant secretary of the Treasury. That was different, but it's true. But, at that time, assistant secretary of the Treasury was the number three man in the Treasury. There was Secretary of the Treasury, the undersecretary of the Treasury. There may have been two or three assistant secretaries, but there weren't more than two or three. And Martin was the main one. So he was kind of number three at the Treasury, whereas when I was at the assistant secretary level—but I had a different title of deputy undersecretary. I was the deputy undersecretary for monetary affairs. There were probably four or five assistant secretaries, and there were two undersecretaries above me.

MR. SMALL. Certainly, Johnson could have had the feeling that just because someone comes from the Treasury and goes to the chairmanship of the Federal Reserve, that does not mean he will not become a pain in the side of the President. Martin came from the Treasury and certainly was a pain to Presidents.

MR. VOLCKER. But it's interesting, because Fowler was such a supporter of mine, but then he had qualms about—I'm sure he had qualms. [Laughter] This acolyte of his was going to be fighting with him all the time.

Anyway, today we were going to talk about my experiences after being at the Federal Reserve.

Working at Wolfensohn and Company, LLC

MR. SMALL. Yes, we were going to discuss your career after you left the Federal Reserve. You went to work at Wolfensohn. In what I've read about your career, that doesn't get a lot of discussion.

MR. VOLCKER. Well, I didn't know what to do when I got out of the Federal Reserve. I sat around. I guess I made a couple of speeches. I went to Japan and made enough money making two or three speeches. I made more than my annual salary—double or more of my annual salary. So I didn't feel under any great pressure to get a job right away. I couldn't figure out what to do, and my wife got disgusted with me; she didn't like all this uncertainty of her husband who didn't know what he wanted to do.

I didn't want to go to one of these big firms as, you know, kind of decoration. I just didn't have any interest in doing that. So I finally said, "Well, I guess, like many other people do, I have to hang out a shingle of my own and say I'm a consultant or something." By coincidence, Jim Wolfensohn, who is an extremely good salesman, had started, on a very small scale, this boutique investment banking outfit—basically an M&A place. And he got a hold of me. I'd known him—not well, but I'd known him some. I thought, "Well, why am I setting out my own shingle? I'll join his shingle." It was the same kind of small-scale operation that I had in mind.

The place that I had been just about ready to go to was Brown Brothers, where I would have made a heck of a lot more money. I also had this bug about going to Princeton. Princeton said, “Well, you can be part time, but we’ll make you a full professor”—I didn’t have a Ph.D.—“we’ll give you tenure.” I said, “Well! Good. I can retire gracefully to Princeton, and they can’t get rid of me, because I’m going to have tenure.” I decided that would be a good thing to do. I told Brown Brothers I wanted to spend a day or two per week in Princeton, and they said, “No, we don’t permit that as a matter of policy.” So I got sore at them. [Laughter] Wolfensohn didn’t care. He just wanted my name. So that’s why I went to Wolfensohn.

I continued at Princeton for several years and spent part of each week there. We lived in a lovely but drafty pre-revolutionary house. I did both undergraduate and graduate teaching at the Woodrow Wilson School until my wife got too ill to make the trip and Jim Wolfensohn left the firm to become president of the World Bank, so I actually had to manage the firm. I wrote *Changing Fortunes* at that time.

At Wolfensohn, I learned what M&A people do firsthand and saw some of the sins of Wall Street. But Wolfensohn was a good firm to go to. He has an ego that was difficult sometimes. But the firm didn’t do trading, for example. All they did was M&A. They were pretty careful about saying, “We’re not quite ready to do any deal that a potential client wants to do.” I felt this was one place, where I was on Wall Street, where I never felt exposed on an ethical or whatever side.

Just for the record, after Wolfensohn left, we had had a former client—had nothing to do with me—but who became, I guess, chief financial officer—he was not chief executive—of a very large company when that company was planning one of the biggest acquisitions at the time, an M&A thing. At Wolfensohn, we didn’t know anything about it. It was all secret. But this

former client called up one of my relatively young partners and said, “Look, we’re in the midst of this deal,” and explained the deal. He said, “We want to announce it this weekend, but we need a fairness opinion,” like all M&As. My partner, to his everlasting glory, in my mind, said, “I’m sorry, but this is Thursday, and we’re not prepared to give a fairness opinion by Saturday when we know nothing about the deal to start with.” This is the kind of thing they’d pay you \$5 million in those days or \$10 million for doing nothing except providing a fairness agreement. The other side said, “Well, all right. I can get some other firm to do the fairness opinion. But I want you with me over the weekend.” So we did get credit for four or five days of work. We got credit for being the investment banker for the deal, which suddenly leaped us into the top 10 or something with one deal. But my partner saying, “No, we don’t do fairness opinions on two days’ notice,” and the client saying, “Well, that’s all right. I can find somebody else to do that. Anybody else on Wall Street will do that” is characteristic of the Wall Street environment.

This is after Wolfensohn left. We had as clients Chase, what then was NationsBank; ING; HSBC (which was one of Wolfensohn’s first clients); American Express; and I think one other big financial institution. Any investment bank would love to have these four or five huge financial firms as clients. And we had them. So we were in a pretty good position. When we sold our firm to Bankers Trust, all those clients left.

I wasn’t really happy about the sale. Prior to the sale, I should have put my name on the door, which I didn’t. My thinking was, “Well, okay, we’re doing a good business here. I can sit here basically being in charge of the firm for a while, then I can ease out. These younger partners can take over, but I’ll stay here for the rest of my working life.” But then this great offer came along, so everybody except me wanted to sell. So we sold. From there, I went to sharing office space with some friends in Rockefeller Center, where I still am.

Involvement with Arthur Andersen, LLP

MR. SMALL. This fairness opinion and “We can get someone else to do it”—I’m making a jump, perhaps, because I know Arthur Andersen is coming up in your career, with the issue of retained accounting firms and their signing off on financials and—

MR. VOLCKER. Yes.

MR. SMALL. Is this done too easily?

MR. VOLCKER. Well, in a way, this was my unhappiest experience. Arthur Andersen was in big trouble. I don’t know exactly what inspired them to come to me. I can’t remember how they expressed it, but something like “You’ve got to come in and save the firm” or whatever. It was pretty strong language. I worked with the Wachtell law firm. They did their work pro bono. They wrote out an agreement that gave me sweeping authority over the whole company. Arthur Andersen in concept couldn’t do anything without my approval, basically.

I began realizing some of the problems, I guess, before I finally agreed to it: “Well, if I’m going to be basically in charge of the company, I’d better meet the management,” although I had already met the senior management guy. And they said, “Well, that’s not so easy.” I said, “Why not?” He said, “Well, one of them is in London, one’s in New Orleans, one’s in San Francisco,” or something, “and two of us are in New York.” I said, “Well, don’t you meet?” “Well, we don’t really meet regularly. We maybe occasionally meet, but we consult on the telephone,” and this kind of thing. I suddenly realized, this firm had no strong leadership in it.

It became increasingly apparent that it had been torn apart by conflict between the auditing partners and the partners on the consulting side of the firm. Eventually, the consulting partners, which are now Accenture, left. Other accounting firms had had the same problem, but when the consulting partners left, they typically left the firm with a lot of money. In the case of

Arthur Andersen, the consulting partners left under terms and conditions, as I remember, such that the continuing firm was left with very little.

What killed them, in my view, was that they decided that they had to rebuild a profitable consulting business. Andersen invested a lot of money into rebuilding a consulting practice. The rebuilt practice wasn't anywhere near as strong as it had been and took a lot of resources. In any event, Arthur Andersen continued to take its eye off the auditing ball, and it really screwed up some audits. Enron was the killer, but they also had a bad case with, I think, the Waste Management Company the year before, and Arthur Andersen had come into trouble with the Department of Justice. Then there were other badly failed audits. There was one scam which the auditors should have caught; it was right under their nose, but they didn't catch it. It was terrible.

But, anyhow, I had all this plenary authority. I was just in the process of trying to learn what to do about the problems at Arthur Andersen when, much to their surprise (and I didn't know enough about it to be surprised), they came under a threat of being indicted by the Department of Justice. That kind of slowed everything down. I don't know whether, to this day, I did the right thing, but I decided it was not my business to get involved with the criminal charge by the Department of Justice. I felt it was not wise to get involved, because the charges dated back long before my involvement. But I thought it didn't make sense to indict the company, because the company would fail. They deserved some kind of punishment, all right. We worked away at trying to maintain some auditing core of the firm, which could have been done without the indictment, I'm sure. But the partners were so split among themselves at that point that they were totally incapable of making a decision and executing it.

MR. SMALL. Split between the auditing and the consulting?

MR. VOLCKER. Yes, I think it was split that way, certainly, but I think it was split some other ways, too, with different loci of power. All these auditing firms are very loosely managed. Arthur Andersen was the strongest internationally. That's what is sad about this: Arthur Andersen was the most centralized, which it should have been. That doesn't mean they were highly centralized, but they were the most centralized and had the most control over the foreign affiliates, and historically had the strongest auditing reputation. Everything went down the drain. In a decade, they went from their company being considered the prize of the lot to a bad story.

MR. SMALL. I think you used the phrase, "They took their eye off the ball."

MR. VOLCKER. No question about it.

MR. SMALL. One possible version of that is that the consulting arm kind of pulled the eyes away or shaded the eyes—

MR. VOLCKER. Oh, no question. Ironically, a little while after I went to Wolfensohn—this was 10 years before I took on the work for Arthur Andersen—they had hired the Wolfensohn firm as a consultant to advise them: Should they split up, stay together, or whatever? I had nothing to do with it at the time. Whatever we advised, I'm sure it was sensible, but Arthur Andersen didn't do it. We did not resolve this bitter conflict, which was the consultants saying, "We're making all the money. Why are we paying it all out to these auditors?"

I used to make a point, which was true, that this company was basically an auditing firm. On their publicity material, when I first saw it, they had an orange oval, which was their kind of trademark. They had this brochure that they gave people that had three or four ovals as to what their principal responsibilities were. Half of one of those ovals was auditing. They had other

ovals for different kinds of consulting, probably. But it was clear, looking at the brochure, that they were not saying that “Our central business is auditing.” They were saying, “We’re a consulting conglomerate.” And that’s what Accenture became.

MR. SMALL. The problem could be that the auditing part of the firm, in auditing the books of a client, would be so stringent that the client would say, “We don’t want to be your client anymore.”

MR. VOLCKER. Yes, but that would be the extreme. In the ordinary course, auditing firms want their auditors to talk up their services as a consultant, which is what they did. Arthur Levitt was trying to fight that practice. And the ultimate is what you say, that they’re all afraid, if they’re too tough as an auditor, they’ll get fired and lose profitable consulting business as well.

Anyway, it’s a very messy story. The Justice Department investigation was led by Michael Chertoff, who has become head of Homeland Security. He was disturbed by the Andersen response, or lack thereof, to an earlier problem—with Waste Management, I believe. And there are stories that he was angry with the main Arthur Andersen lawyer. My sense was there were some Arthur Andersen partners who were willing to see Arthur Andersen go out of business or were not willing to do the things that were necessary to save it. They had no interest in what I was proposing. My effort was hanging by a thread, and then they got indicted and it was hopeless.

The irony is, of course, that the conviction has been reversed. They were convicted on a side issue, as to whether one of their own lawyers, who I think was probably an honest woman, sent a memorandum or email, at some point, saying to destroy certain files. I think the final decision by the Supreme Court, or whatever court it was, said that she was within her rights to send that particular memo or email.

MR. SMALL. If I remember correctly, what she sent out said something like, “Here’s our long-standing procedures for destroying documents.”

MR. VOLCKER. I think that’s right: “Follow them.” Yes. I think it was before they were officially notified that they were under investigation. But, obviously, there was some discussion about it. You may well be right. Apparently, she said to follow their regular procedures.

MR. SMALL. Which included directions for destroying documents.

MR. VOLCKER. Yes, after a certain period of time. Anyway, that was a sad story.

MR. SMALL. At some point, you moved on to reparations from the Nazi—

MR. VOLCKER. Well, that was before, I think. It began when I was still at Wolfensohn.

MR. SMALL. It’s a bit of a stretch to see how the former chairman of the Federal Reserve fits into this Arthur Andersen problem. But if you had worked at Wolfensohn with their consulting business, that makes some sense.

MR. VOLCKER. Well, they were just looking for somebody that had credibility, of course.

MR. SMALL. But you must have had your doubts that anything could be done in the Nazi thing.

Commission on the Dormant Accounts of Victims of Nazi Persecution in Swiss Banks

MR. VOLCKER. Well, the Nazi thing came about because, unbeknownst to me, there had been negotiations between a private Swiss banking organization—the Swiss Bankers’ Association or whatever it’s called— and, I guess, the World Jewish Congress. They’d been fighting about this for who knows how long. They finally decided they would resolve this by

setting up a committee, with three members appointed by the Jewish side and three appointed by the Swiss side. Then they had to get a chairman. I knew nothing about this, but both sides came to me and urged me to do this. I had worked with the Swiss a lot during my career, but I don't know why the Jewish side decided to trust me, but anyway, they did.

It was quite a mess. It started out with a certain amount of goodwill. I mean, they negotiated this themselves. But there were a couple of people on the Swiss side, you know, who were not very eager, wanted to block everything. There were some aggressive people on the Jewish side that thought the Swiss had deliberately robbed them blind.

MR. SMALL. Was the fundamental issue on the Swiss side that "There are these assets, and we don't want to give up control," or was it "We pride ourselves on and make a living off our secrecy, and we don't want to break this secrecy"?

MR. VOLCKER. The secrecy thing, which they had agreed, in part of this negotiation, to give up in at least a limited way for this particular purpose under this committee. It was sort of a pride in being Swiss. I mean, the Swiss live on legend, and not entirely incorrectly, that they were the saviors of Jews during the Holocaust, and that they were doing right by the world. It wasn't Swiss to think that they had absconded with the money. We never pinned down how much was done deliberately. But, you know, it didn't fit the Swiss image at all. This effort was challenging their sense of themselves in the world: secrecy, integrity.

MR. SMALL. But were those assets being held as deposits under the ownership of other people? They weren't owned outright by the Swiss banks, were they?

MR. VOLCKER. No, no. Presumably the deposits were from people trying to hide their funds from the Nazis. The deposits were from Germans, but actually more from Poles in the end, maybe because the Poles had a little more warning. Some of the funds were deposited

directly by those people or by some friend. I suspect most of it we never were able to identify. Probably the biggest losses were funds deposited through agents, Swiss agents, who may have started out with a friendship thing, but they were kind of in the business of “We will deposit the funds for you in our name.” I think we all suspect that this was the biggest volume. But that was the hardest to identify, in the end. I don’t think there’s much question that if you were an agent for a Jewish family in Germany or Poland, and they hadn’t been heard from for five years after the war, you said, “Well, you know, they went to Buchenwald, and here’s the money. I could use this money.” I’m sure a lot of that went on. But that was very hard to find.

I assumed from the start that this was going to be not a simple, but a straightforward negotiation in which the Swiss would be willing to pay, I don’t know, \$100 million to get it off their back. And the Jewish community wanted \$2.5 billion or \$5 billion or whatever. We would have a little negotiation and, after a few months, settle it for \$150 million or something, because I didn’t think we could find anything.

The “trouble” was partly due to Mike Bradfield, who’s a birddog. I had him as my general counsel on this committee. We pressed the banks for what information they had. They all said, “We don’t have any. In Switzerland, we don’t keep the records beyond 10 years, by law.” Or I guess the law said, “You can destroy them after 10 years. If you don’t hear from anybody for 10 years, if it’s dormant for 10 years, you don’t have to keep the record.” They did not, in general, have an escheat law. In the United States, if that happens, the funds get escheated to the state government, usually. Most of the Swiss cantons had no law like that. So a suspicion was that what the Swiss typically did was to keep charging very high fees. If you charged high fees for long enough, the account disappeared, because there was no interest being earned on the deposit. Well, at least that was one technique.

We started out thinking we couldn't find any of these funds and documents, but the Swiss banks got pressed for what information they had. And then, lo and behold, they may not have had records in the head office, but maybe in some of their branches. They had a lot of records going back 50 years. Some of the records were, you know, hidden in some mountain in Switzerland or something.

It turned out they had a lot of records. The records were nowhere near complete, but they had a lot. And the records varied a lot. We got a lot of names. They had a record of a name, but some of them didn't have any record of the account activity, just a name. You might have known when it was opened with a name. Some actually had, you know, that the deposit was so much and it was closed because of fees, or it still existed in some cases. I think we got a fairly good handle on the number of accounts that were in Swiss banks and the names of the victims. But you had fragmentary evidence on the amounts.

I was told the other day the last case had been adjudicated. This is now more than 10 years later, and they're finally closing up the reconciliation process. And this last decision was one of the biggest outstanding cases. I know the people involved a little bit. I ran into them the other day, and they told me it had been settled—unsatisfactorily, from their standpoint. But this is a wealthy family, a well-known family, a Jewish family in Germany that said they had a lot of money in the Swiss banks. I guess there was a record that they had money, but there was no record of the amount. I think, given the nature of the family, it was plausible that they could have had a lot of money, but there was no evidence for it.

MR. SMALL. These were assets that had been voluntarily placed in the Swiss banks? They were not assets that were stolen by the Nazis and hidden there?

MR. VOLCKER. No. Not stolen by the Nazis. But that got mixed up with our case. I think there was one bank in Switzerland that was kind of considered a vehicle for stolen money, which had then merged with one of the big Swiss banks. It wasn't in our mandate to look into it. But I remember some discussion about it.

Well, there were two complications. I don't know when the official Swiss investigation into the money stolen by the Nazis or by Swiss citizens started, but it was more or less coterminous with our efforts. The Swiss government decided they would investigate with a broader mandate for investigating the role of Switzerland in helping or hurting German refugees. This was headed by a distinguished Swiss historian but was an international tribunal. They, unlike us, had subpoena power. So if they had our mandate and our manpower, they might have been able to find more. But they sort of left us alone. We cooperated, but if we had more time, we probably could have cooperated more. They had some chance of getting after the agents holding the refugee funds. They had reports this thick. I think it was a good report. They were quite critical of the Swiss.

At one point during the war, the Swiss apparently turned back refugees. They were letting them come in, and I can't remember what happened. The Germans, I guess, put pressure on. At some point, the Swiss began turning back refugees at their border—which left a sour feeling, to say the least. Probably got sent back to go to Buchenwald, I'd say. And they investigated all that.

Then another thing that went on—different Jewish groups brought this case, in Brooklyn, against the Swiss banks and made a demand for billions of dollars. It was a complication for us, because we kept stumbling over each other. The Swiss were outraged by all that. I thought the court was going to throw the case out, because it could have on a number of grounds: The crime

was in Switzerland. It wasn't in the United States. It was mostly about claims with no real evidence beyond hearsay. It was all speculative. But Judge Edward Korman, who I got to know, decided he wouldn't throw out the case. He never accepted the case. I guess he said to the Swiss banks and Jewish community, "Look, I don't want to decide this. You go negotiate it."

So this negotiation was going on parallel to our investigation. That was just a pure negotiation. About the time we got finished, they finally made a deal, which was broader than ours. It was for a billion and a quarter dollars, if I remember correctly. And the judge said that the first claim on this money is for the claims we discovered, because we'd been working with them. But this money from the Swiss banks was to cover other claims, too—for forced labor, in particular. The Jewish side wanted big reparation for forced labor and big reparation for something else. Maybe part of it was kind of just charitable. So the judge said, "Okay."

I think that money is still hanging around, too. But it was integrated with our study, in the sense that the money, which came from the Swiss banks, was the source for the money to pay off the claims that we found. We got dragged into the reconciliation.

But we made the report. The report was unanimous, in the end. We concluded that the Swiss bankers did not have an organized effort to dishonor the Jewish claims, the Swiss banks did not have an agreement to hide these accounts, but they did hide them without a common agreement, and they were not sufficiently responsible in dealing with the claims that were made. So it was a balanced report. The Swiss were not guilty under the antitrust law, but they were guilty under the moral law. Both sides agreed to that.

Then we were faced with the request: "Since you're so involved in all this, you go on and reconcile the claims with the money from the Swiss banks." We decided, rightly or wrongly, to do this with great care. We set up this reconciliation process with many lawyers in

it. Every claim, however big or small, got looked at and an effort was made: “What proof do you have? Do you have any evidence at all that the account was there? Did you find out from Grandma Emma’s sock that there was a bankbook? Do you have any evidence at all?” And then, if we had any evidence, we’d run it through the names on all the accounts. We had a fairly clean record of, I guess, the total number of Swiss bank accounts. You could run the claimants against the list of Swiss bank accounts and see how many matches there were. There were a lot. But it was very tedious. Once you knew that, it’s, “Okay, it’s a match. Yes, we understand they had an account. Do you have any evidence of how big the account was in the Swiss bank? Well, that may have been the initial deposit, but our records suggest they must have withdrawn it, because it doesn’t exist anymore.” Well, who knows?

Management Style

MR. SMALL. In thinking of your decisionmaking process and “Should I get involved or not?”—Arthur Andersen and this Swiss/Nazi thing seem very different, in one sense. You said with Arthur Andersen, you started with sweeping powers.

MR. VOLCKER. Nominally, anyway. [Laughter]

MR. SMALL. But you gathered all your chips.

MR. VOLCKER. Yes.

MR. SMALL. But on this Nazi thing, how did you go about thinking about whether it was feasible, was there any chance of success? Or was your motivation just goodwill?

MR. VOLCKER. Well, they had agreed upon the mandate, and they had agreed to cooperate before I got involved. I mean, they came to me saying, “We’ve got this agreement. All we need is a chairman.” I didn’t jump at this. I put it off and said, “No, I’m not interested.” The deciding factor with me, I remember very clearly, was the Swiss central banker Fritz

Leutwiler, who I was very close to and who was very helpful to me in the Latin American debt crisis and so forth. At that time, he was a director of Nestle. He was a good friend. He kind of begged me to do it. He said, "It's very important to Switzerland, and you ought to do it." At some point, he said, "You won't find any records, so all you've got to do is mediate an agreement. Tell them 'There's no evidence, gentlemen, on either side. Why don't you settle this for \$250 million?' or whatever. It'll only take two or three months." [Laughter] So I agreed to do it. He was the one who really persuaded me to do it.

MR. SMALL. Thinking about your decisionmaking process, I'll hearken back to one particular episode. You talked about being Chairman of the Fed and the problems at Chrysler and Doug Fraser coming in, and you said, "Well, I had all the chips."

MR. VOLCKER. I didn't quite put it that way, but I did.

MR. SMALL. And you talked about Arthur Andersen. And in some sense, you've got a lot of chips.

MR. VOLCKER. Yes.

MR. SMALL. But at the Board, it's a very different management style—more of a cooperative decision.

MR. VOLCKER. Correct.

MR. SMALL. Do you have principles that you follow or specific things you look for?

MR. VOLCKER. At Arthur Andersen, on paper, I had all the authority. The worldwide chairman signed off on all that authority. I think I insisted the U.S. chairman sign off, who was somebody different, I guess. But the foreign people said, "Well, that's not us. We did not give him the authority to sign. So you may think you have the authority, but we're the people on the line here, and we're not necessarily going to jump when you say jump."

Then the chairman [Joseph Berardino] finally resigned. He was a pretty good guy, I think. But he was under so much pressure, he resigned. I forget whether I initially suggested that he resign, but I had the authority. I could fire any of these people. It didn't get to the point where I actually fired him. But he was right. He'd reached the point, with my agreement, that he ought to resign. Well, that was okay, but then we couldn't find anybody else who wanted to do it. We could not find anybody to take his responsibility to be in a responsible position in the company.

Then I began realizing how fractured it was. Finally, they kind of twisted the arm of some guy in Chicago to become chairman and presumably responsible to me. He was an old Arthur Andersen loyalist and decided somebody had to do it. But he couldn't make a decision because the whole company was so split and riven. It got to the point where some people in the company wanted to break it up. It got so bad, I remember, whenever I'd say, "Get this guy and this guy in my office in the next three hours because I want to talk to them." They never appeared. They just defied me. [Laughter] Eventually, they came. But this was the last gasp, at that point.

It would have rebuilt a much smaller company—but you could have ended up with those partners who really were interested and loyal to the old Arthur Andersen auditing culture. We could have had a firm that would have been the best auditing firm. I don't know how many clients it would have had. You would have lost some of the big clients, but it would have had enough, because it would have been much smaller. I think it would have survived at maybe a quarter the size that it had been, at a third the size that it had been. It would have had a good reputation for auditing. Well, the world of auditing lost a competitor, and we lost what would have been the most disciplined one.

I went out and gave a speech about this at Northwestern at the time when it was all collapsing. It's so ironic. Arthur Andersen himself was a big contributor and maybe a professor at Northwestern. And his successor, Leonard Spacek, was idolized in the firm and was a very strong auditor and straight down the middle. I went out and gave this lecture about the downfall of auditing and Arthur Andersen at the Spacek Lecture Room in Arthur Andersen Hall at Northwestern. It was so ironic. Here are these great monuments to the old Arthur Andersen.

I wonder to this day if I should have gone to Washington on my knees and begged for Arthur Andersen's life, as Warren Buffet had done in similar circumstances with Solomon Brothers. For sure, the government action was a mistake, but Arthur Andersen brought it on itself.

MR. SMALL. Maybe I'm pushing this too hard, but I'm thinking of situations where, in deciding to take the position, you thought you had clear authority. I'm thinking of stories about Chairman Miller, who was a very successful and hard-driving CEO. When you get into managing the Board, the structure's very different. It's more cooperative.

MR. VOLCKER. It should be.

MR. SMALL. If some M.B.A. is going to be reading this transcript and trying to cull out some of your management principles and how different situations require different skills, what would you say about managing something on the cooperative model, like the Board—and also where there's not a clear bottom-line objective, such as profits. There's something more diffuse, like social good. Is this really something people have to be careful of when they come from one—

MR. VOLCKER. Oh, I'm sure. I'm sure it drove Chairman Miller batty, that he didn't have executive authority. I don't know that he complained. But he grew up in the corporate

world where a chief executive is a chief executive. He didn't grow up in this world where you put up signs in the board room, "Thank you for not smoking," which only induced Henry Wallich to smoke even more. I don't think Miller got used to it.

MR. SMALL. But at the Board, a Chairman would have to do more to bring along the Reserve Bank presidents or the Governors.

MR. VOLCKER. Yes.

MR. SMALL. Coalition building might be needed. Did you ignore that, and just say, "This is—"

MR. VOLCKER. Well, I probably ignored it in one sense. Suppose I had become Chairman of the Board in 1965 or 1966 at age 37. I probably would have been scared to death. I would have been trying to corral a bunch of people who were more senior than I and who thought they knew more than I knew, even if I might not have accepted that, even then. You had the Reserve Bank presidents. You had Al Hayes at the New York Fed, who'd be about as interested in listening to me as to the man in the moon. It would have been really difficult, and I probably couldn't have managed it. It would have had to have been highly collegial.

When I became Chairman of the Board in 1979, there was no question in my mind—maybe in other people's [laughter]—that I knew more about the Federal Reserve than almost anybody in the Federal Reserve. And not just about the Federal Reserve itself, but also about the Federal Reserve's relationships with the rest of government, because I'd seen it from the other side, and I knew what the Treasury was like, and I knew about the relationships between the Treasury and the Federal Reserve and between Washington and New York.

That, plus the fact that you had a kind of a sense of crisis, I wasn't quite the scared bunny that I might have been [laughter] in 1966. That was beyond my imagination. When I became

Chairman in 1979, I had a big problem, but I thought I knew as much as anybody else about it, including the behavior of the Federal Reserve and the internal dynamics of the Federal Reserve. Of course, when they began appointing Governors who were not simpatico with me, whether it could have been different or not, I don't know, but the result was, we had a big conflict. That's not the way it should be, because then you lose the sense of trust on both sides that you need. So I was lucky in the first four years or whatever it was—not so lucky in the second. In the first five years, maybe I was lucky.

So that doesn't give you any management model.

The Inquiry into the United Nations Oil-for-Food Scandal

MR. SMALL. To put you into a different management model, you jumped into the issue of the United Nations (UN) and the Oil-for-Food [Program].¹³⁷

MR. VOLCKER. Well, that was an interesting experience.

MR. SMALL. But you got a strong mandate from the beginning, didn't you?

MR. VOLCKER. It was strong, yes. I mean, again, the UN officials didn't all accept that. But, formally, the mandate was very strong. What I insisted upon then was, I didn't just do it at the request of the Secretary General. I wanted a resolution out of the Security Council, and I got a resolution out of the Security Council. They all told me it was unnecessary, but I wanted the psychological advantage of being supported by the ultimate authority.

I was part of a committee. I turned out to be very lucky, in that sense, because it was decided to be three people. I didn't have any problem with that. I guess I essentially had a veto. I was given a veto over the other two. Two names had been nominated by member states. I didn't know either of them, but I did a little bit of investigation. One of them I was a bit

¹³⁷ See Volcker (2006, pp. vii–xxxiii).

concerned about, because I'd heard from some people that sometimes he could be hard to get along with. But they both turned out to be great towers of strength. One member, Richard Goldstone, you know, is now in the news because he wrote this report about Israel and Gaza. He is Jewish, but his report was, in part, critical of Israel. So he is anathema now to the Jewish community. At the height of the apartheid conflict in South Africa, he was the head of a commission to investigate the police and the army for malfeasance of various sorts, and he wrote, I guess, a pretty hard-hitting report. That kind of made his reputation as a strong fellow. So his was one of the two names.

The other guy was a Swiss lawyer, Mark Pieth. He is a great expert in international corruption. He led an OECD effort—The Anti-corruption Convention of the OECD is largely his doing. He was an advisor to the OECD, and he was the bird dog on that thing. So he knew a lot about the law and the intricacies of all this.

We had a hard time getting organized, but I had a stroke of luck. I went to a couple of highly recommended U.S. attorneys or assistant attorneys, and they turned me down. The woman who was the lead prosecutor in the case against Enron was one of them. She hemmed and hawed for a few weeks and turned me down and took a job at a law firm. Another guy was recommended to me who I didn't know but I talked to. He was interested initially. But it was a very iffy proposition, so neither of them wanted to get too involved. The pay was no good either. They were intrigued, but they did not see a good answer, let me put it that way.

Then a Canadian friend of mine said, "Hey, I've got the guy for you,"—a Canadian, Reid Morden, who had actually once worked in the Canadian embassy to the UN in a more junior position, but he eventually became the top civil servant in the foreign service in Canada. That means he's the number two man. They have a Minister and then they have the chief civil

servant. There had been some scandal in the atomic energy outfit, and he was placed in charge of that agency for a while. He was in charge of the Canadian CIA for a while. But he was between jobs at the time. I called him up, and he came down. He agreed to do it. It turned out to be terrific. He had just the right management touch. He was older than the other investigators by a long shot. He had an experience that they couldn't really question as leading an investigatory agency and also having all kinds of foreign contacts. We had a bunch of young, eager investigators. Unlike the people who didn't want to take charge, they were all eager to get involved in this high-profile, worldwide investigation. There was one big glitch—a staff member left in a huff with confidential documents. But apart from that, we had the right staff. We had the right guy to manage it, and we had a bunch of highly experienced—and inexperienced [laughter]—investigators who were very eager to get after all these crooks!

I'd never been so directly involved in any investigation. To see these investigators go to work was kind of an eye-opener. Everybody outside said, "You can't do anything. You haven't got any subpoena powers." I learned that it's wonderful how much people will talk when they're not forced to! [Laughter] It's incredible. It's not because you walk in there with a subpoena. That may, obviously, help at times. But people, as soon as they begin talking at all, they can't stop! So you keep finding out all sorts of things that you thought you would never find out.

The Swiss were very cooperative in opening their books as much as they could. This wasn't something that happened earlier. They leaned over backwards to try to be careful—not outright violating their secrecy laws, but going as far as they could in providing information within their competence. We didn't have any legal authority with them, but we did have that resolution from the Security Council that said "countries ought to cooperate." The Swiss had just become a member of the UN. I presume they didn't want to get in a fight with the UN when

they're brand new members. They really did lean over backwards to help. To the extent we could pin people down, it very often was because we had sufficient bank records from Switzerland.

MR. SMALL. You mentioned, I believe in the introduction to the book *Good Intentions Corrupted*, that one of your preconditions in bargaining with the Security Council was, you made it known that you may need to become very obnoxious about getting records.

MR. VOLCKER. I don't remember now. I mean, I don't know how formal it was. It was certainly on my mind. I certainly must have made that point in getting the Security Council resolution. The least cooperative countries were Russian and China. They were so uncooperative that you just kind of had to give up. They were just closed.

One of the British companies had come forward and confessed—probably they knew there was going to be an investigation. But we had not been after them. Eventually, we probably would have gotten to them. But they came forward and confessed, which was kind of embarrassing to the British. But the British really did not cooperate. They always said, “Yes, you'll get the records.” But it was always the “next month” or whatever.

MR. SMALL. Was this just pride?

MR. VOLCKER. Well, a lot of British companies were involved, and they were embarrassed. As things evolved, they got caught, you may recall, a few years ago with this BAE Systems contract in Saudi Arabia for a lot of airplanes—billions of dollars. There's an accusation that Saudi Arabia was bribed to buy, I guess, from BAE instead of somebody else. This was big scandal.

This came out in the open, that this British company was bribing a foreign government. It became a big issue politically in the U.K. At one point, toward the end of the thing, whatever

he's called, the chief legal official in the British government, went to the House of Lords, which has final court jurisdiction over all these things. He said, in language almost as blunt as this, "There are more important things than the rule of law. This is a matter of national security, and we're not going to have any further investigation. We won't permit any further investigation." So this led to a bit of a brouhaha.

At that point, kind of to save face and after doing nothing substantial to investigate the Oil-for-Food thing, the agency that was supposed to investigate serious fraud said they were so busy with Oil-for-Food cases, they didn't have time for this other BAE Systems case, saying, "Well, we really are serious about this Oil-for-Food." As far as I could tell, the Serious Fraud Office seldom, if ever, discovered a serious fraud, so they weren't very busy. But the British government said, "We've given the Serious Fraud Office another £50 million specifically to investigate Oil-for-Food stuff." And they appointed a new guy to head it. I don't know what happened. By that time, I was all out of it. He came around to see me. I don't know whether they ever found anything or not. I think they maybe did a little something.

There was an accusation that a senior French official close to [Jacques] Chirac (President of France, 1995 to 2005) was involved in Oil-for-Food and was getting favors. The go-between was the official's chief adviser. The Iraqi records showed that this adviser was involved. The French official essentially claimed, "Well, that was my assistant. That wasn't me. I had nothing to do with it. I'm sorry. I'm totally innocent." The French did some investigation, and they were on this case. Somehow, the case dragged on and on. We cooperated with the magistrate, and he cooperated with us. Somehow, before this magistrate completed his investigation, he got transferred to the hinterland. I guess the investigation was just dropped.

MR. SMALL. Someone could think that the UN is so large and has such a strange governance structure, plus you have all these other locations of power in the member governments that have sovereign rights and protections—

MR. VOLCKER. Yes.

MR. SMALL. —that someone could just say, “This is ungovernable.”

MR. VOLCKER. Yes. I reached that conclusion. I was very disappointed in the UN. The UN is an important institution. The United States ought to support it. The problem is, you’ve got corruption of the petty sort embedded within the UN, you know, purchasing agents taking kickbacks, and you also have nonfinancial corruption. It’s got some good people in there. But trying to get something done within the UN is awfully difficult.

This whole Oil-for-Food thing was rather threatening to the United Nations. It became a political issue in the United States, which is why they had the investigation. But getting the UN to move—pff. They had all the facts there, black and white, and who did it. It’s so silly, in a way. Within the Oil-for-Food Program, a highly experienced undersecretary general and administrative head of the Oil-for-Food Program within the Secretariat ended up taking money—we identified about \$150,000. It may have been more. It’s just kind of sad that he couldn’t restrain himself. He went home to Cyprus. He claimed he got all the money from his old aunt in Cyprus, who, as near as we could find out, had no money to start with. She fell down an elevator shaft. He’s actually living in her apartment. I guess he’s getting paid retirement from the UN.

The UN had a follow-on investigation to ours. Our mandate was Oil-for-Food corruption, but we ran across some corruption in the purchasing department on a substantial scale. One of those people was involved in Oil-for-Food, so that’s how we got involved. They felt it necessary to follow up and investigate the purchasing department. The man doing the

investigation is one of our investigators. He had his own little investigating team. It went on for a year or two and was digging out all sorts of stuff. They closed it down just in the past six months. They said, "Well, we don't need this special group anymore. We'll combine it with our internal group." But the internal group hardly exists now. It's had no head. The woman in charge, she's pretty tough. She is frustrated too, I guess. They apparently just dropped any pretense of a real internal investigative mechanism now. That didn't make any sense to me. But that's the way the organization is. But, happily, just recently I heard a different and more positive story. Reportedly, the organization is much more sensitive to corruption and is dealing with it. I hope so.

The small countries were always complaining that they don't have any voice in the UN. I attempted to tell them, "Look, here's your chance to get a voice. You ought to get in charge of the internal investigations. You ought to make sure the organization, which is directly in your responsibility, has an organizational structure and has people to follow up." We said they ought to have some outside group, which they finally did appoint, and they ought to have a powerful undersecretary for administration, which they don't have, and they ought to report to the General Assembly if you want to have some voice in the organization. They just don't pick it up.

I had to address the General Assembly a couple of times. You sit there, and there are 192 members or something. They're sitting there. There are probably 2 people in the seats for each member. So to have an informal discussion with them, you're sitting there with 400 people who aren't going to say anything. It's not a setting for encouraging any substantive discussion. The only discussion I had when I talked to them, and later the Security Council, was that the General Assembly members were worried about their prerogatives. The discussions never got to the substance and didn't last very long. The Security Council ended up doing nothing. You've

got the Chinese and the Russians, which, in this internal matter, stonewalled everything. What kind of an organization is it?

MR. SMALL. One could say, at the most general level, “Here’s an international organization with lots of money,” and be a cynic and say, “It’s bound to perform poorly.”

MR. VOLCKER. Yes, but it doesn’t really have lots of money.

MR. SMALL. But those two characteristics, international with lots of money, are characteristics, I guess, of the IMF and the World Bank. But, I would take it, your views on their management and performance there are quite different from that of the UN. What explains that?

MR. VOLCKER. The World Bank is a much more straightforward bureaucratic organization, with lines of command that are more or less recognizable. This was lacking for the United Nations. Our investigation, which was Oil-for-Food, found financial chicanery, which shouldn’t have been there even if it was petty cash on a Wall Street standard. At the same time, the UN was having a lot of corruption in peacekeeping, which is their main administrative function these days. That should be the core of what the United Nations does. In some ways, it is the core. They were not very good at going after corruption in their own peacekeeping operations. They’re protecting countries that are supplying the troops. They’re kind of at the mercy of countries volunteering peacekeeping forces, and they feel unable to maintain any discipline over them. I mean, it’s just symptomatic of the way the whole organization works. I’m sorry it’s that way.

MR. SMALL. I’ll be flippant here, but I think I’ve discovered your source of success. You put yourself in situations where there’s a lot of money flowing around—the Nazi-era accounts, the UN Oil-for-Food Program, Wall Street. And free-flowing money brings out the worst in people. So you stand straight when all this stuff is happening around you.

MR. VOLCKER. [Laughter] You're probably right.

MR. SMALL. Your parents set you right early on.

Involvement with Other Organizations

MR. VOLCKER. I don't know why this sticks in my mind, but we used to go to a lake during part of the summer. We'd rent a cottage, which I'm sure wasn't very expensive. We had a rowboat and a canoe. But other people had big Chris-Crafts going around the lake. They didn't have water skis then, but they had boards that were pulled on behind the motor boats. It was a board, not a ski. I would say, "Mother, why can't we have a big Chris-Craft the way they do?" She would say, "They've probably all got mortgages." [Laughter] Our family didn't borrow money.

MR. SMALL. We can get into another issue if you want, but it's very recent. You have been giving advice on financial issues nowadays. But are there other issues that tempt you?

MR. VOLCKER. Oh, look, all these issues that come along—I'm a sucker. I'm trying to get out of one today. I have been involved in three or four nonprofit organizations that are doing good, but they live on the edge of defeat and bankruptcy all the time. I originally got involved with some of them because, in my small family, we had diseases—not all that many. But my wife had very severe arthritis. She was diabetic all her life. We've got a son with cerebral palsy. So, lo and behold, I'm all involved in a cerebral palsy organization that's always on the edge of running out of momentum. For some reason, I'm chairman of the board. What have we got? Cerebral palsy, Arthritis Society—I had diabetes at one point.

MR. SMALL. I remember, at the start of the Obama Administration, maybe when he was President-elect, your name came up with the Palestinian issue.

MR. VOLCKER. Oh, yes. I'm surprised you saw my name there. There's a guy, Henry Siegman, who once was head of the American Jewish Congress. But some of the Jewish community sees him as a sinister anti-Israeli, I guess. He's obviously not a Jew-hater but he, historically, has been very critical of Israel and thinks that their aggressiveness and inability to come to terms with a realistic effort to come to peace with the Palestinians may be as much their fault as the Palestinians' fault. Israel doesn't like to be told that, but he's open about it. In some ways he is overboard in his criticism of Israel and their policies. But he has this group [the U.S.–Middle East Project] which I agreed to be a member of.

Do you remember Casablanca, when the Jewish community and the Arabs were going to make peace with Rabin? They'd had a big celebration at the White House. They were off to be happy, with great potential for economic development in the Middle East, if they only cooperated. They had this great convention and a great get-together and love-fest in Casablanca. They arranged to have another one in Amman, Jordan, six months later or whenever, which I actually went to. I wasn't involved in Casablanca.

But the Council on Foreign Relations, where Henry Siegman then was, set up this group of Americans, Europeans, Arabs, and Israelis to make recommendations as to how they should cooperate together economically, in their mutual interest, in the midst of all this flowering of cooperation. We had a good report, actually. But, obviously, the whole thing fell apart. That was my involvement in Israel and with Henry Siegman, who I guess was running that effort in the Council. So he developed this group. It's got Brent Scowcroft and Zbigniew Brzezinski and, I guess, Carla Hills and Nancy Katzenbaum, Jim Wolfensohn and Theodore Sorensen.

His view is that that peace in the Israeli–Palestinian conflict was very important in the whole Middle East, which I believe—but a lot of people do not believe or don't want to believe,

but I believe. If you could settle the Palestinian–Israel thing, it would be such a relief to the Arabs, and they would then be more encouraged to go after Iran. I think it would make a big difference.

Anyway, Siegman got this group together—I don't recall precisely what it's called, but it still exists—of these so-called notables. He wrote a letter to Obama after he was elected, expressing his view that “You ought to make it your big foreign priority to get the peace process restarted in the Middle East. You won't be able to do it without the United States putting forward the outlines of a plan,” which everybody knows anyway, but—“You've got to put the United States officially behind that, because otherwise neither side will ever get off the dime, because it's politically impossible for either of them to take any initiative.”

So, actually, Obama made some noises that sounded somewhat sympathetic. Then he made that speech in Cairo, which arguably was the beginning of exactly that approach. He told the Israelis: “You've got to get together with the Palestinians, and the first step is, you've got to stop the settlements.” Obama was very open toward the Arab side. So everybody thought, “Well, maybe he got the message.”

But there's never been enough follow through. Now it's all blown up again. Siegman is so discouraged now he's about ready to give up, I think. But now you begin hearing, “Yes, the United States has to take the initiative, and they've got to outline the plan, or otherwise nothing gets done.”

The Volcker Rule

MR. SMALL. Do you have anything to say about financial regulation and the Volcker rule, or have you had your say innumerable times?

MR. VOLCKER. I said it innumerable times. Keep my fingers crossed. I think it's in the Senate bill, although there's some question whether it's in there. You know, the summary says it's there. And then all the opponents look around and say, "Well, some of the language in the bill isn't quite consistent with my idea. Maybe the regulators can decide later whether they want to do it," and so forth. I don't think that's the intent. We're trying to get that cleared up. It's true the regulators have six months to do anything. But that's all right. This isn't something you can put into effect tomorrow. There are things I like in the bill and things I don't like so much. But there's been so much attention to the so-called Volcker rule that other parts are less discussed. I don't agree with every proposal, but I don't want to get involved in every issue.

MR. SMALL. Even if you could get the Volcker rule, that would be one of several pieces—

MR. VOLCKER. Oh, of course. And it's not the most important. I think it's important symbolically. I want to treat the banks with access to the safety net differently than the rest. I can't do that if commercial banks and other financial institutions, such as investment banks and hedge funds, are all doing the same activity.

The underlying argument, in my view, is that commercial banks are special. That was the traditional view. Commercial banks always have been treated differently, and they should continue to be treated differently from other financial institutions, such as investment banks and hedge funds. The opposing view is, "No, that's old fashioned. Everybody's a hedge fund now." So you treat them all alike. That's not a vision, even now, that I agree with. I think the banks do things that are kind of indispensable and ought to be treated specially.

People say I'm an old fogey, that I don't know the new world, and so forth. I've got an answer to that now. Somebody said to me the other day, "You know, you remind me of a movie

I saw 5 years ago, 10 years ago. The name of the movie was *Back to the Future*.” I don’t know the movie, but it is a fairly well-known movie. So that’s my slogan: I want to go back to the future. [Laughter]

The derivative thing also is very important. The resolution authority is very important. We all love the resolution authority, but none of us know how to make it work, frankly. We’d like to project onto the resolution authority all our questions and doubts, and it is going to solve them all.

MR. SMALL. From doing these interviews with you, Jerry Corrigan, and others, it is clear that there sure have been a lot of financial crises. Once you sit down and do the timeline, there have been a ton of them.

MR. VOLCKER. That’s right. And they’re serious. There were several really serious ones.

MR. SMALL. One view is that everyone knows how to provide protection against such crises, and that is to have banks and other financial institutions hold more capital. But that’s one thing markets are good at avoiding. Is it a false hope to think that you’re going to get these institutions to hold sufficient capital?

MR. VOLCKER. Well, I sort of agree with that, but I think it’s partly due to an inevitable regulatory and supervisory weakness relative to the lobbying efforts of the banks. But also, there’s a limit as to how much capital you can require of banks and keep them competitive. I want the banks to have as much of the market as they can have. They’ve lost a lot of the market. I don’t want them to lose any more, and I’d like to see them regain some. But if you make the capital requirement too high, they can’t do it. Now, it can be higher than it was.

I'll make a statement that I don't know whether I want to support or not: This is not a crisis of the lack of capital. Banks were basically better capitalized, on paper, than they've been in the past. It's a crisis in the size of the losses. It doesn't make any difference whether their capital ratio was 8 percent or 10 percent or 11 percent when the losses are 15 percent! I told you this story: When I first became president of the Federal Reserve Bank in New York, Walter Wriston came to visit me and said, "We don't need any capital at all." Part of his argument had an element of validity. He said, "No matter how much capital we have, if our loans go bad, there's going to be a run on the bank, and we won't survive." So that's true whether we have zero capital or whether we have a lot of capital. He was exaggerating, but there's something to that.

MR. SMALL. But how far a crisis propagates across other banks would be mitigated by—

MR. VOLCKER. I'm not against strengthening the capital requirements, but there's a limit to how much you can do it, and there's a limit to how much gumption you will have to maintain it anyway. I mean, I would never leave the so-called Volcker rule up to the regulators. They'll never do it. That's what the opposition to the Volcker rule said: "Well, maybe it's a good idea. We'll leave it up to the regulators." I know what will happen then. [Laughter] They'll study it and say, "We haven't had a crisis yet, and we don't have to do it now!" They'll do more and more and more studying. And then, its, "Oh, no! Now we've got a crisis." Too late. [Laughter] That's the life of a banking regulator.

Current Issues with Money Market Funds

MR. SMALL. Any other issues you want to talk about?

MR. VOLCKER. Well, money market mutual funds. I'd like to get much tougher restrictions on them. This issue has kind of dropped out of the discussion. The Administration took this up. I can't remember whether it's in the House bill or not. I think there may be something in the House bill—but not enough. It's a seemingly secondary issue that, amid all the other controversy, is going to be forgotten, which is too bad.

MR. SMALL. I can see the argument for regulating them or treating them like banks, because they—

MR. VOLCKER. They act like banks.

MR. SMALL. But on the other hand, I guess one could argue they haven't been a source of problems.

MR. VOLCKER. Well, they turned out to be a big problem when the recent crisis came. You know, when Reserve Primary Fund went bad, there was such a panic; the Treasury guaranteed them all.¹³⁸ If you have to guarantee them, they've got a problem. They have no capital, they've got no regulation, they've got no insurance, they got guaranteed. They got guaranteed through the Treasury by the Exchange Stabilization Fund, of all things. What a travesty.

But they're insidious, in my view, because they've taken a lot of money that should be in the banks. A lot of it's going back to the banks, but they take their cut out of it. If they didn't exist, banks would be bigger, and banks would be making more loans. That's my argument. There'd be less commercial paper and more bank loans, which, by and large, I think would be a good thing. They are big, and they're no longer a sideshow. I think they're \$4 trillion or so.

¹³⁸ Editor's note: The Reserve Primary Fund was a large money market mutual fund. On September 16, 2008, during the Global Financial Crisis of September through October 2008, it lowered its share price below \$1 (thereby "breaking the buck") because of exposure to Lehman Brothers debt securities.

MR. SMALL. Someone's going to go back to earlier parts of our interviews where you talked about the professor in London who said, "It's got to be in banks, because they're better at evaluating credit, and—"

MR. VOLCKER. And they're easier to control.

MR. SMALL. But then you said, "I learned that the first premise is false." Then they are going to look at what you said about Citibank, which is that it was a bank running too close to the edge, and they will say, "Well, why is it such a good thing to take money out of money market funds and put it into banking institutions if Paul Volcker doesn't believe those institutions are good at evaluating credit, and they run too close to the edge and always get in trouble?"

MR. VOLCKER. Because money market funds are only facilitating that process. Or they're sticking the money out opportunistically in the market, promising to do things they can't do.

MR. SMALL. Is it also because they don't, in your view, provide a crucial service with the funds—they're just buying securities, whereas a bank is doing evaluation of credit?

MR. VOLCKER. To some extent, they're kind of covering up the risk that they have, which isn't all that great. Most of them are owned by somebody else. Individual funds have gotten in trouble before, but their sponsor bails them out because it hasn't been that expensive. Now, what happened with Reserve Primary Fund is, it didn't have a parent. So when they got in trouble, there was nobody to bail them out. The Treasury then started a program to guarantee the deposits of money market funds in general. But money market funds have become a kind of semi-banking adjunct to—well, it used to be to investment banks or insurance companies or whatever. In my view, it weakens the banking system.

You've got a handle on the banking system. You're supposed to regulate it. You're supposed to protect them. But I don't want to protect everybody. That's going back: Back to the future!

Final Thoughts on Regulation and the Volcker Rule

MR. VOLCKER. What I don't understand is, why is it so difficult to get the Congress to embrace the Volcker rule with open arms, I mean, just on the face of it? The more the banks dislike it, the more populist it is. Everybody's against speculation and all those bad things. Hedge funds have a bad name. Private equity funds are rapidly getting a bad name. Why isn't everybody saying, "Yes! That's absolutely right!" I cannot walk five blocks down a street in New York without somebody saying, "Get after those banks! Keep after 'em! I agree with everything you say!" For goodness sake, I'm an old guy, and they're interested in what I say about equity funds and speculative trading in banks. It's not health care. [Laughter] Why is Congress so reluctant?

MR. SMALL. A very cynical point of view, and I'm sure unfair to particular members of the Congress, is campaign funding.

MR. VOLCKER. Well, that, obviously, must be part of the answer. Even then, it is literally true that I can't find more than four or five institutions that the Volcker rule substantially affects. It affects other banks, in the sense of what they might like to do someday, but the great mass of American banks has no interest in this. They're not big enough. They're not equipped. They never thought of doing it. In fact, they don't like these big banks. They don't care, I guess, because they're not affected one way or the other. So there's no real political energy behind implementing the Volcker rule. Many banks may think it's a good idea, but it doesn't hit home with them.

MR. SMALL. One criticism I've heard is that the Volcker rule is more government intervention in the free markets to solve a problem that doesn't exist, because the crisis did not start—

MR. VOLCKER. Yes.

MR. SMALL. —with the proprietary trading.

MR. VOLCKER. Right. I don't think it's the weakest part of my argument, but it's the least understood. And I remind you, this wasn't the heart of the crisis. Critics ask, "Why are we wasting time on this?" My answer to that: "If you don't watch out, it'll be the heart of the next crisis."

It's a conceptual point. I want to treat banks differently than I treat other institutions. The Volcker rule deals with a major point of differentiation between the functions of a commercial bank and the functions of the rest of the financial system. If there is no differentiation, then the opponents of the Volcker rule are right: Treat them all like hedge funds.

But what is the ultimate consequence of treating them all like hedge funds? It's that every big institution is going to be saved, one way or another. You're not going to have any brake on the speculative activity in any part of the system. I don't think it's very stable. You are right—they say, "Why do we have more intrusion in the system? We don't need this." If you go the other way, you're going to have more intrusion into the system, because the net result is, you've got to regulate all those other people almost as much as you regulate banks.

People don't catch on to that part of my thinking. You put a capital requirement and a leverage requirement on Goldman Sachs and Morgan Stanley and so forth, assuming they give up their banking licenses, but you don't send in an army of regulators. What are the regulators going to do? Are they going to look at every trade they make? And Goldman and Morgan are

not making bank loans. What are you going to regulate? Are you going to tell the Goldman Sachs and others not to do proprietary trading? The point is, they should not have access to the safety net.

MR. SMALL. The part of the argument that does seem to have legs, so to speak, is when you start with, "When you're on the government dole, then you come under certain regulation."

MR. VOLCKER. That's right.

MR. SMALL. Otherwise, you lose access to the dole.

MR. VOLCKER. That's right. The argument that resonates is: Do you really want to subsidize Goldman Sachs? I wish there was somebody else out there, because I don't want to always pick on Goldman Sachs personally. I was almost a partner at one point. But they're the last of the Mohicans standing, so it is a symbol. But, you know, not a week goes by when there isn't some scandal on Wall Street. [Laughter] The question is if that is what you want to subsidize.

MR. SMALL. So here is how I understand your rationale for the Volcker rule. Commercial banks play a critical and somewhat unique role in the financial system, in that they perform three interconnected functions: (1) They offer checking accounts, which are payable on demand and at par; (2) they provide credit to those who do not have access to the capital markets; and (3) they operate the payments system.

MR. VOLCKER. Correct.

MR. SMALL. As a result of them having this unique role, you want to extend the safety net to them, by which you mean access to the Federal Reserve's discount window, deposit insurance, and other almost paternalistic protections. By doing so, the government enhances the

stability of the financial system in particular and of the economy more generally. There are social benefits that follow from provision of the safety net.

MR. VOLCKER. Yes. The safety net is, in effect, a significant government subsidy to the recipient.

MR. SMALL. Furthermore, because commercial banks have, and are seen by depositors and investors to have, access to the safety net, they can get large and highly leveraged. They can get, as we say, too big to fail. This is an outcome you are not pleased with, but you are willing to live with because of the crucial roles we noted that commercial banks play.

MR. VOLCKER. Yes, but with the important proviso that the Dodd-Frank legislation grants the FDIC resolution authority as a workable quasi-bankruptcy procedure. Management and creditors and stockholders are at risk—although that is not yet generally understood in the marketplace.

MR. SMALL. But you are not willing to extend the safety net to purely trading operations and thus enable them to get too big to fail.

MR. VOLCKER. I think that is a fair summary. But I would add that proprietary trading in a commercial bank may affect the culture of that bank by providing, more widely throughout the bank, strong monetary incentives for trading and short-term profits, which I think does not enhance the stability of the bank and the functions it provides.

MR. SMALL. Chairman Volcker, we will close on that thought. Thank you.

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