Paul Volcker has served as undersecretary of the Department of the Treasury and president of the Federal Reserve Bank of New York. His eight-year tenure as chairman of the Federal Reserve began in 1979, one of the most challenging economic periods in modern U.S. history.

In this interview, Volcker discusses his experiences at the Federal Reserve, including his fight to end the recession, and his views of globalization in tomorrow's economy.

The Education of Paul Volcker: The Austrian School vs. Keynesianism

INTERVIEWER: Can we talk a little bit about your early influences as an economist? Were you exposed at all to the Austrian School of economy?

PAUL VOLCKER: I happened to have been exposed when I was an undergraduate, because my first teachers of economic theory came from the Austrian School, and this was in the late '40s. They were not all enamored of Mr. Keynes and the Anglo-Saxon traditions of economics, so I had a pretty good exposure to the Austrian School and Mr. Böhm-Bawerk and all his friends.

INTERVIEWER: You went to the London School of Economics, didn't you? Did you find it a hotbed of left-wing thinking?

PAUL VOLCKER: No, all my friends to this day associated all those things with a hotbed of socialism, and that impression, of course, was created by Socialists. Harold Laski was a big influence, but not in the economics department. The economics department actually was quite conservative. People didn't believe that Hayek was a leading writer in the economics department in the London School of Economics for some years.

INTERVIEWER: Did you pick up some of the influences of Hayek?

PAUL VOLCKER: No, but I had read *The Road to Serfdom* when I was in college, I well remember. At that impressionable age it made a very considerable impact.

INTERVIEWER: How were you influenced by Hayek and *The Road to Serfdom?* How big an impact did it make on you?

PAUL VOLCKER: I don't know if I can quantify it, but it was a very persuasive argument—the glories of a free-enterprise system, and at that time there was a pretty active debate about socialism, at least in the rest of the world, and to some degree it hit the United States. This would have been after World War II... and socialist thinking had gone pretty far. This was pretty big, this warning about where it might lead and possible excesses. I am not as conservative as Mr. Hayek's followers, but it was a very powerful story.

INTERVIEWER: When you were at Harvard you found that the orthodoxy was almost purely Keynesian, didn't you?

PAUL VOLCKER: At least part of it was. I had Alvin Hansen, who was a leading Keynesian disciple in the United States, as a professor at Harvard, as everyone did in the graduate school at that time, and that was straight Keynes, right down the line. It was all a debate then as to whether Keynes made sense. But the Hansen logic was very straightforward and very convincing.

INTERVIEWER: You said Keynesianism was almost a religion at Harvard when you were there?

PAUL VOLCKER: They did have other people there, you know. John Williams was the other macroeconomist there, certainly financial-side, and he was a very skeptical practitioner. He didn't spend all his time professing, and he advised the Federal Reserve back in New York at great lengths. I can't say everybody was Keynesian, but the younger school certainly was. It was Paul Samuelson, Jim Tobin, and all of them had grown up in the Keynesian climate. I didn't know them all, but they were all circulating. They were the bright young stars of Harvard at the time.

INTERVIEWER: When did you begin to have doubts? How early did you begin to become skeptical about things?

PAUL VOLCKER: I was already skeptical. I guess I'm skeptical about everything. I've gotten worse in my old age, but I was a little bit turned off by the precision and certainty that these people attached to the doctrine. The analytic framework was very convincing, but this feeling they had, that they could press the right buttons and manage the economy pretty exactly, for some reason it turned me off. I was very skeptical that they were not overselling the precision of this theory and the precision [with] which they could run policy.

INTERVIEWER: Was that a gut instinct, or was that something you picked up?

PAUL VOLCKER: It must have been a gut instinct. I don't know why, but I was just a little bit turned off by the sense of certainty that they had.

INTERVIEWER: You actually talked about the administrations of Kennedy and Johnson, and you used the word "hubris" in that context. Would you say that that kind of attitude reached a peak?

PAUL VOLCKER: Yes,. There's no question in terms of its policy application that that approach reached its peak in the Kennedy-Johnson years, when in the Harvard years it was still intellectual concept. It really hadn't permeated fully the political decision-making [process]. It hadn't reached its apogee, which it certainly reached in the Kennedy-Johnson days, and they felt they'd solved the problem in the business cycle. They'd solved a problem with macroeconomics; it was time to turn to other microeconomic things, [and] it was time to turn to welfare questions, because they'd solved the problem. I'm not exaggerating very much when I say that. They had a very long period of economic advancement, and things were going pretty smoothly. Productivity was high, and unemployment was low.

Nixon's Suspension of Gold Convertibility, and Wage and Price Controls

INTERVIEWER: Can you tell us how the United States under President Nixon ended up with wage and price controls?

PAUL VOLCKER: That's a bit of a mystery, [but] I suppose [I can explain] at least to the degree to which we have done. You know the general background: There was a recession at the end of the '60s and the beginning of the '70s, and from a domestic standpoint, the recession wasn't all that severe. Inflation had begun creeping up, maybe more than creeping, and it continued through the recession. After the recession there was a great sense of disappointment that the inflation rate had not come down, even in the face of recession, and at the same time the underlying weakness of the dollar internationally had come to a head.

The dollar is the center of the financial system, convertible into gold, with other countries having a fixed exchange rate against the dollar. That whole framework had come under great pressure, and it was clear that something had to be done.

The United States finally faced up to the fact that something had to be done about the international monetary system against a background of this continuing inflationary problem. So the two dimensions came together, the external dimension leading to a suspension of the gold convertibility of the dollar, which itself raised, in an orthodox way, inflationary questions with the devaluation of the dollar and stalled the depreciation of the dollar. There was a good deal of pressure for vigorous action to have some kind of controls, some kind of income policy, something. While the administration had opposed all this talking, when they finally bit on that particular hook they went all the way, and it was full-scale price and wage controls, and it lasted much longer than I had intended. I actually thought at the time that some kind of a freeze might be a good thing, like when we were devaluating. I had in my mind three months, but I suppose it lasted three years. Of course it wasn't three years, but it was more than three months, and it turned out to have all the problems that price controls have.

INTERVIEWER: At least we proved it doesn't work.

PAUL VOLCKER: Yes, it certainly was very difficult to sustain. I don't think we did all the things that were necessary in terms of fiscal policy or monetary policy to help make it work, but to help avoid a more severe depreciation of the dollar, it seemed reasonable to me at the time.

INTERVIEWER: Were you at Camp David the weekend when gold convertibility was suspended?

PAUL VOLCKER: Yes, I indeed was.

INTERVIEWER: What was the atmosphere like?

PAUL VOLCKER: It was a little bit mixed. Arthur Burns, who was then chairman of the Federal Reserve Board, argued strenuously enough to suspend gold convertibility. He was really the only one who vigorously took that view. I think most of the rest of us who were involved thought the time had come and some approach had to be taken, and that the only practical move internationally was to suspend gold convertibility, which would lead to a depreciation of the dollar. It was not a permanent solution, in my mind, but it was a necessary transitional step. The president, I think, had become pretty well convinced before he was up there. The surprise to me was the way it was politically shaped, with Mr. Nixon and Mr. Connally presenting it to the world as a great triumph. This was America exhibiting its strength and power, dealing with speculative pressures in an appropriate way and seizing the moment to deal with the price question at home, and at the same time there was actually a tax reduction on there. The economy responded favorably; the stock market responded favorably. There had been very ominous predictions of what would happen to the stock market. The stock market went up instead of down.

INTERVIEWER: What about the price controls? What was it that changed President Nixon's mind? He must be the last person you would think would do that.

PAUL VOLCKER: It was this combination of needing to do something about the international side and awareness that [it] might increase uncertainty. [It was] being presented as a defeat against a background of prices rising over 4 percent a year, which was higher than the historical norm. It was one of the highest peacetime inflations—even at 4 percent, it was considered a lot in those days. I don't remember exactly what it was. This was his opportunity to respond to all the pressures to do something about that.

INTERVIEWER: And look strong?

PAUL VOLCKER: And look strong. I am sure that Mr. Connally [Democrat John Connally, Nixon's Treasury secretary, 1971-1972] had something to do with his thinking. His other advisors I don't think liked it much, but Connally and the Treasury were very dominant in policymaking at that moment, and the others were brought into the story rather late in the game.

INTERVIEWER: Whatever they tried to do wasn't a long-term fix, was it?

PAUL VOLCKER: It certainly was not a long-term fix, either internationally or domestically.

Stagflation: An Inevitable Consequence of Keynesianism?

INTERVIEWER: The word used at the time I think was "stagflation." What does that word mean now?

PAUL VOLCKER: I don't remember just when that word started. It's an ugly word, but it became very popular over the 1970s, when you had this combination of inflation, which didn't go away and was getting worse, and the economic performance at the same time was getting worse. You had a very big recession by our postwar standards in 1975, and again the inflation rate didn't go down, at least [not] for any length of time. There was this feeling that we were caught in a box that we didn't know how to get out of, where you had international instability of the dollar, domestic inflation, domestic instability, rising unemployment, and low productivity. It was not a brilliant economic period.

INTERVIEWER: Would you see this period as an almost inevitable consequence of Keynesian or pseudo-Keynesian policies?

PAUL VOLCKER: An inevitable consequence of Keynesian policies I don't think is quite fair. What I thought at the time, and I wasn't alone in this, was the defeat of Keynesian policies took place in the mid-1960s, when there was recognition among most of the Keynesian policymakers that it was time to increase taxes and more reluctantly time to take money. That was resisted by President Johnson vigorously on political grounds. [Johnson was fighting the] War on Poverty and fighting the war in Vietnam at the same time, and the Vietnam thing was becoming more and more costly. In my view, he viewed a tax increase at that time as a kind of referendum on the war.

Volcker at the Fed: "Slaying the Inflationary Dragon"

INTERVIEWER: At the end of the decade you find yourself being sworn in by President Carter. How did you feel about the job? Did it seem very daunting? Were you anxious, apprehensive?

PAUL VOLCKER: I suppose [I found it] inevitably daunting.... This all came about rather suddenly, so I didn't have a lot of time to worry about it. But in retrospect it wasn't such a terrible time to become head of the Federal Reserve, because everybody was unhappy with what was happening, and there was an opportunity to make things better. [When] things got better you would have felt some sense of accomplishment, but it was not an easy time then.

INTERVIEWER: Did you feel that inflation was your number one, I think you used the phrase "dragon to slay"?

PAUL VOLCKER: I certainly thought that we had to deal with inflation, and the great advantage I had was [that] finally the country had more or less come to that [same] conclusion. There was this feeling of malaise, to use a term [popular] at the time. There was a kind of great speculative pressure. It was the years when everybody wanted to buy collectibles from New York. The market was booming, and other markets of real things were booming, because people had got the feeling that things were inflating and there was no way you could stop it.

INTERVIEWER: What did you see of the risks? Were you concerned about the future of democracy if this went unchecked?

PAUL VOLCKER: I'm not sure I was worried about the future of democracy. I was certainly worried about the future of the United States in terms of its place in the world. I grew up in a generation where you naturally look upon the United States as being the last great hope of mankind. We were the dominant economic power, the dominant military power, [and] the dominant security power. By and large we were in favor of the right things, and [if] we weren't strong economically, we weren't going to be able to carry out what I saw as reasonable responsibilities in the world.

INTERVIEWER: You used to talk about slaying inflationary dragons. What did you set out to do?

PAUL VOLCKER: I certainly thought that inflation was a dragon that was eating at our innards, or more than our innards, and if anybody was going to deal with this it was going to have to be the Federal Reserve. I saw a lot of roles, not just my personal role, but [also] the need was to slay that dragon.

INTERVIEWER: Can you in general terms explain what you did?

PAUL VOLCKER: That's a complicated story, but what we did, against a background of increasing unease about inflation and increasing unease about the performance of the economy, was to face up to the need and [take charge of] monetary policy and control of the money supply, to accept the proposition that at the end of the day inflation is dependent upon inflationary monetary growth, too much money growth, too much credit growth, and we set out to make that point and say that we've just got to stop this and draw some kind of a line in the sand about how much money and credit growth was appropriate. In doing so, the effect was to push interest rates up in the short run, because people were expecting inflation; they were perfectly willing to borrow. It was a good thing to borrow when you expect inflation, and the borrowing came up against a limited supply of money and credit. Interest rates were way up, and sooner or later that was bound to have an effect on the economy. It did, and we had a severe recession, but we came out of that recession with a very strong movement called price stability and also with strong economic growth.

Now my view always was, and has remained, that the way the economy was behaving, sooner or later you were probably going to have a recession. There was a feeling that the Federal Reserve created the recession. I think economic conditions created the recession. That created the underlying conditions and imbalances that sooner or later were going to give you a recession. Better to deal with it sooner rather than later.

INTERVIEWER: There was public concern about inflation, and yet you thought it gave you a mandate, as it were?

PAUL VOLCKER: Yes. Well, at least strong support, enough support to go through a very difficult period.

INTERVIEWER: And did you or anybody quite expect how tough a time it would be with inflation at 20 percent?

PAUL VOLCKER: If you had told me in August of 1979 when I became chairman of the Federal Reserve Board that interest rates, the prime rate would get to 21.5 percent, I probably would have crawled into a hole and cried, I suppose. But then we lived through it.

INTERVIEWER: Did you feel any sort of personal pressure? People were really hurting, weren't they? You were getting letters?

PAUL VOLCKER: Builders are always most affected by tight money, and they said, "We're not getting any use for these two-by-fours," so they sawed them all up and we used to get hundreds of two-by-fours delivered to the office making a plea to do something about this situation. Some of them were given as [a way to say] stop this recession and stop this inflation, reduce the money supply, which of course is what we were trying to do. The message had gotten through, but I remember quite clearly—you remember these things, or you see these things through your own eyes. But even though the homebuilders were the most singularly, strongly affected industry, [there] was a clear sympathy, even there among their leaders, as for what we were trying to do. They would come in and see me frequently and understandably be disturbed, but their plea was, "Can we get this over with as soon as possible?"

Shock Therapy, American Style?

INTERVIEWER: You said somewhere that this was no time for gradual or half measures. [What was needed was a] sort of shock therapy, American style. But why not take a longer view?

PAUL VOLCKER: Because I thought we had a problem in expectations, and inflation is a good part of expectations. You begin expecting it, and you get it, because wage earners will want more wages, and businessmen will put the prices up because they think they can sustain it, and that whole thing sustains the process. Gradualism, which had been a bad word at the time I took office, had been developing, and it gave you this feeling that we could deal with this problem gently, and that [if] we just go about it in this sophisticated way we can do it with relatively little pain. [This] never seemed realistic to me... [It] sent the wrong message. I can remember going through the stuff that the staff was preparing for congressional testimony or in our annual reports explaining our policy, and the word "gradual" kept appearing. I used to cross it out every time, because I wanted to get the message through that once we'd started the process we wanted to finish it.

INTERVIEWER: Were you afraid the matter would go wrong, that it wasn't going to work?

PAUL VOLCKER: I suppose so, but my most worrisome time was ... '82 for two reasons: The recession was in full swing, and we'd had a lot of forecasts, including within the Federal Reserve, that we'd probably come out of the recession first after '82, and that didn't happen. So that was disappointing and worrisome to say the least. At the same time there was an international crisis—Latin American debt just exploded—and we had some domestic banking problems. They all came to a head more or less at the same time, so that was a difficult and worrisome period, without a doubt.

INTERVIEWER: And what was your worst fear at that time?

PAUL VOLCKER: I suppose the international crisis, which was severe in terms of its impact on Latin America and elsewhere. The banking system was very exposed, much more exposed than in the [recent] Asian crisis in '97 or the Mexican crisis in '94. The banks had gotten very heavily extended into Latin American debt. So between the pressures at home and the international crisis, there was real uncertainty about the banking system, which was the biggest problem.

INTERVIEWER: If the banking system was to go, what were the problems then?

PAUL VOLCKER: You would have compounded the problems of the already difficult domestic and international business situation. We would have had a much tougher time climbing out of it.

INTERVIEWER: ... You [received] all sorts of hardship letters when you were fighting inflation. How did that make you feel?

PAUL VOLCKER: It didn't make you feel very good. I didn't probably see the most insulting letter; I was probably insulated. But they would show me some of the more poignant [letters] sometimes. You have to go on the basis, which I strongly felt, that while we were going through a very difficult period, if we got through this period with correct policies, and particularly if we got through the period and slayed the inflationary dragon, the prospects for the economy would be greatly improved. If we didn't face up to it, we didn't face up to continuing what we've begun.... We'd been through a lot of the agony.... If we didn't carry through we would be everlastingly sorry. And feeling that you had made things a little bit easier for a few people would not have been borne out anyway, because they would have found out that the situation would have, in a relatively brief period of time, deteriorated, not the opposite. When we'd launched so much, invested so much credibility, so much policy, so much hardship in changing the direction, not having been successful would have been the big tragedy.

There's a lot of difficulty and obviously a lot of pain. I had the feeling at the time—and I still have the feeling—that what made it all possible was a general understanding widely shared, and this on the side of the public, that something had to be done, and there was a kind of instinctive feeling that it wasn't going to go away with out some pain. But something had to be done, so we had a fair amount of support. I'm not saying we would have won a popularity contest—there was a lot stuff in the Congress and the state legislatures, resolutions of complaint and so forth. But I think there was a body of support in the country, right through this period. Obviously if there wasn't, we wouldn't have survived. ...

[Inflation] came to be considered part of Keynesian doctrine, although I don't think it was Keynes himself—there's some debate about this—[who said] that a little bit of inflation was a good thing. I was strongly lectured on that. I remember one particularly, one of my professors at Harvard [lecturing] about [how] in the postwar period people were worried about sluggishness and that a little bit of inflation is a good thing. Of course, what happens then [is] you get a little bit of inflation, and then you need a little more because it props up the economy. People get used to it, and it loses its effectiveness. Like an antibiotic, you need a new one; [then] you need a new one plus. That was a world... I was not part of. I was in the Federal Reserve, Treasury, a conservative guy who's always against inflation. The general tenor of the times was inflation was the least of evils, if it's an evil at all. What changed drastically in the 1980s and running through today is the presumption that inflation is bad [and that] the primary job of a central bank is to prevent inflation. That's taken for granted.

The great ideology these days is that the central banks ought to be independent; they ought to have an inflation target, and an inflation target ought to be close to zero. That's a very different environment then the '50s and '60s and into the '70s.

INTERVIEWER: You saw inflation as a moral issue, to a certain extent?

PAUL VOLCKER: To some extent I think it is. Inflation is related to monetary policy. It's related to the issue of money. The issue of money is a governmental responsibility predominantly, and to use that authority in a way that leads to inflation is a system that fools a lot of people, and to keep fooling them you have to do it more and more; [that] is a moral issue. I put myself in that camp.

INTERVIEWER: But why a moral issue? What does it actually corrode?

PAUL VOLCKER: It corrodes trust, particularly trust in government. It is a governmental responsibility to maintain the value of the currency that they issue. And when they fail to do that, it is something that undermines an essential trust in government.

INTERVIEWER: What impact did the [control of] inflation, which you led, have on the economy we have today? What was the long-term effect?

PAUL VOLCKER: I would like to think the position that the, I won't call it the conquest of inflation, but the relevant control of inflation has had a lot to do with creating the conditions for a sustained economic growth. I used to make speeches [to that effect]... at the beginning of the '90s, before the technology revolution became so pronounced. We had a very good opportunity, given the relative stability of prices, given the relative balance in the economy, given that we'd been through the banking crisis and resolved it domestically, for a really long period of sustained growth. And the first half of the '90s that's what's happened, at a slower rate of speed. Now it's picked up, and obviously this technological revolution has had a lot to do with it beyond price stability. But also the technology has helped maintain reasonable stability in prices. I worry a little bit that that might be changing. The United States is pretty blasé about what's going on in prices now, but we do have the highest rate of price increase of the developed world. It's not very high; it's not out of control—I'm not suggesting that at all. But we're running a little bit closer to the wind than we were.

From Carter to Reagan

INTERVIEWER: In your position at the Fed, you were extraordinarily independent. Not many countries' central bankers are quite that independent. Do you think President Carter regretted appointing you?

PAUL VOLCKER: I don't know. I haven't asked him that question directly; he'd probably be polite and answer ["no"]. But he's never really criticized me publicly. I'm sure it made him uneasy. He kind of [appeared uneasy] on one campaign appearance, but only one campaign appearance. I once asked him whether I cost him the election, and he smiled and said there were a few other influences as well. And let us not forget about the Iranian hostages and so forth.

INTERVIEWER: What was President Reagan's stance toward what you were doing?

PAUL VOLCKER: I saw him from time to time, but I was not a close intimate of President Reagan's. His entourage in the White House, or certainly in the Treasury, were very critical at times. They were... kind of a funny mixture. They had monetarist doctrine, supply-side doctrine, libertarian doctrine all mixed together, so some of it wasn't terribly coherent, which helped me a bit. There was unhappiness because there was a big recession early in his term, and things were not really stable. But he himself never criticized me directly in public, certainly. I always had the feeling that he was urged to do so. [It seemed] that every time he had a press conference somebody was urging him to take a slap at the Federal Reserve, but he never did, and I don't know why. I speculate that he was not a highly sophisticated economist. I'm sure he didn't understand all the arguments his own people were giving him. He did understand that he didn't like inflation, and I think he had some kind of a feeling that the Federal Reserve was trying to deal with inflation.

INTERVIEWER: In the late years, was there a Reagan revolution?

PAUL VOLCKER: I think there was a Reagan revolution in terms of the cutting edge of this moving back from this feeling that [if] you've got a problem, the government would answer it. Here's a big brother here to help you, as Mr. Reagan used to mock, but if it's true that we needed some cutting back in this exuberant view of government, which I happened to share, he certainly did it with some vigor. He did it in a way that helped restore the confidence of America in America, which had been lost, or at least greatly eroded, during the 1970s.

INTERVIEWER: Was the air traffic controllers' strike a watershed?

PAUL VOLCKER: Yes, I think it was, and that's not often appreciated. One of the major factors in turning the tide on the inflationary situation was the controllers' strike, because here, for the first time, it wasn't really a fight about wages; it was a fight about working conditions. It was directly a wage problem, but the controllers were government employees, and the government didn't back down. And he stood there and said, "If you're going to go on strike, you're going to lose your job, and we'll make out without you." That had a profound effect on the aggressiveness of labor at that time, in the midst of this inflationary problem and other economic problems. I am told that the administration pretty much took off the shelf plans that had been developed in the Carter administration, but whether the Carter administration ever would of done it is the open question. That was something of a watershed.

Margaret Thatcher, and the Similar Courses of Britain and America

INTERVIEWER: Mrs. Thatcher seemed to admire what you were doing. She demanded, insisted, or invited herself to see you?

PAUL VOLCKER: She did come to see me, and she came to me often. Leaders of foreign countries, when they came to Washington, they wanted to see other people in the government, and they would invite me to come and see them. She always came to see me, which was always slightly embarrassing that the prime minister of the UK was driving into the Federal Reserve garage instead of the other way around. In some ways what we were doing was paralleling what she was trying to do, and even in some ways on the inflation side it was very close. She admired tough monetary policies. We got along pretty well.

INTERVIEWER: What did she talk to you about when she came to see you? Was she seeking advice or moral support?

PAUL VOLCKER: I think both. She would ask typical questions about what's going on in the American economy, but she was certainly looking for reinforcement of her own ideas about the importance of dealing with inflation in the UK. She probably thought she was giving me moral support, which she was.

INTERVIEWER: Why did she keep coming to see you rather than the other way around, and what's the significance?

PAUL VOLCKER: I don't want to make much of that; it probably [happened] twice. I don't know how many times she came to Washington when I was there, but I would stop in and see her, and she would invite me to come and see her when I went to London. I saw her much more frequently in London than I did in Washington.

INTERVIEWER: Looking from Washington, what did you think of what she was trying to do in Britain?

PAUL VOLCKER: I was a great admirer of hers. She was taking a tough stand, trying to change the direction of Britain. They had had a lot of the problems that we had in the 1970s, so I had enormous respect for what she was trying to do. I thought she was much tougher than I ever would have been [in] non-monetary areas. I may have been reasonably tough, but in other areas she was much more driven than I was.

INTERVIEWER: Why is it that Britain had gone much further down the socialist road than you ever even contemplated? Why were the problems so similar?

PAUL VOLCKER: To the extent they were rooted in unfortunate interpretations of Keynesian doctrine, including this idea that inflation wasn't so bad and [that it was] better not try too hard to get rid of it, it had a common cause with the British problem, which was essentially deeper than ours was. We had the Vietnam complication, which they didn't have, but structurally they had gone much further down the road of government control and socialism than we had.

Retreating from the Commanding Heights: A Worldwide Movement

INTERVIEWER: Do you feel that when Mrs. Thatcher "slayed the inflationary dragon" in Britain and began to privatize and the Americans began to deregulate, it marked the beginning of a world movement?

PAUL VOLCKER: I think so, yes. There has been this great change in attitude towards policy and a great change in attitude towards central banking. For me this was epitomized by Arthur Burns. In many ways I'm a great admirer of Arthur Burns. He was a great economic scholar. He delivered a great lecture a year or so after he left the Federal Reserve, and it was emblazoned on my mind. I sat through the lecture, entitled "The Anguish of Central Banking," and it was a long plea to understand the difficulties of central banking and the difficulties, and even impossibilities, of dealing with inflation in the modern economy when there were so many other points of pressure and pressure groups that went in the other direction, leaving the Federal Reserve—[and] by implication central banks generally—rather impotent. That attitude changed in the 1970s, and what happened in the United States, similar to what happened in Britain, had a big influence on others.

I had to give a similar lecture a year or two after I left, so I entitled my lecture the "Triumph of Central Banking," but I put a question mark after it, and I think the question mark should remain. I wonder about whether the central banks aren't getting a little [less hubris] and a little more chastened now, but for a while you would have thought central banks should just run everything, and everything they did was right.

INTERVIEWER: What seems to have happened over the last 15 or 20 years is that there's been a huge retreat of governments from the commanding heights of economy. Is that fair?

PAUL VOLCKER: Yes. One of the things that occupies me and one of my big concerns has always been monetary policy. The importance of government and the importance of good government are somewhat related to the inflation point. There's been enormous erosion of trust in government generally, including, in the United States, a lack of confidence in the government. It's hard to get people, good people, to serve in government. The United States always has a healthy skepticism about government, but it erodes into a cynicism, which isn't very healthy. I find myself getting cynical about it. Now, of all people, I spent 30 years in government, and I have great respect for the importance of government, and when I become cynical about it, it's a bad sign. Part of the difficulty may well be that there was too much hubris, [the] feeling the government could do everything and do it well and getting [control of] the parts of the economy that it turns out they couldn't do so well. They tried to do too much too soon and get into areas where performance fell way short of reasonable expectations, and now we've had a reversal, which I think to a considerable extent is a reaction of that and [is] probably healthy.

INTERVIEWER: But you feel it's gone too far?

PAUL VOLCKER: The reverse movement? I don't think it's going too far. We're seeking some reasonable balance, [but] I don't know if it's going too far. ... I'm a believer in more universal health care than we have, and that takes a certain amount of government intervention. But there are areas where we did try to do too much. There's welfare reform. I had nothing to do with it, of course, but it's a very interesting experiment in pushing back the boundaries of government in some areas and whether apparently a healthy reaction.

With Globalization Comes Volatility

INTERVIEWER: Do you feel that... free-market policies have gone too far?

PAUL VOLCKER: Oh, yes, that can go too far, too. We [face] different challenges today. And what is preoccupying everybody is globalism, this globalization issue, which is here to stay. [There is] no way you're going to stop globalization when it's so easy to transact business around the world, so cheap and easy. You pick up a telephone, and you're on Mount Everest and telling your wife you're dying. This is a new world, and you're not going to stop globalization. It's given rise to a great deal of instability in international financial markets, more than is healthy.... It leads to underlying economic distortions that we don't fully recognize. It certainly leads smaller countries into what has become repetitive crisis.

INTERVIEWER: But do you feel that the basic... global market is unstable...?

PAUL VOLCKER: The volatility and instantaneous nature of capital movements combined with the technology that leads everybody to be an expert on everything and leads to very quick decision making gives rise to a degree of volatility in exchange markets that is particularly damaging for smaller economies. If you're in the United States or if you're in Europe now with the euro, you can ride with the punches. Most of the business is internal, and you're not that much affected. But if you're in a small emerging economy, very highly exposed to international capital movements, very small relative to [other markets,] you have a problem.

There is a potential difficulty that globalism and modern technology for growth comes up against the degree of volatility that will undermine the process. We haven't got an answer to that yet, but in Asia, where we had a great crisis, there's a certain amount of self-congratulation these days that the crisis is behind us. There's been a good recovery, but as we speak, that recovery is not getting these economies back on the tram line that they had before the crisis, the tram line that was well established before globalization. We have some distance to go to make good on what, I would agree by any kind of analysis, ought to be a great opportunity for improving welfare [and] improving growth most of all among those small economies.

INTERVIEWER: You led the charge against the gold standard. Do you feel that some sort of fixed exchange rate should be used?

PAUL VOLCKER: I certainly agree with more stable exchange rates. What we are seeing and will see is that some economies will search for some way to get some stability and they will be driven a bit to abandon their own currency. You already see that going on with half a dozen or a dozen countries around the world that are either adopting the dollar or adopting the euro or adopting a currency board which comes close to the same thing other countries are talking about. It's not so easy for countries sitting out there in Asia that have no natural anchor, so to speak. They have very diversified trade. It's a fairly easy question for Mexico. It's got big political questions that are very heavily [reliant] upon the United States anyway, and a lot of feeling in Mexico [is] they'd be better off using the dollar. There's some merit to that, and we're being pushed in that direction. The big countries are relatively self-satisfied. You may see the world breaking up into regional currency zones. I don't think we're going to go to a gold standard. Someday, but not in my lifetime, [and] not in your lifetime, we'll have a world currency or something looking like it.

INTERVIEWER: But the free marketeers would think that was terrible.

PAUL VOLCKER: Even if some of them do, some of them don't.... There are people that say, "No, you'll lose all your opportunity for flexible domestic policies." The other side of that is if flexible domestic monetary policies haven't helped a lot of countries, it's been abused or is abused by the volatility of the markets. So some people say, "I want a little integrity, I want a little stability, and I give up a little autonomy."

INTERVIEWER: You're now heading this International Accounting [Standards] Board. Obviously the big question for the future is creating the rules for the global economy. ... Looking at the new world economy, can it work without the rules, or is it just the law of the jungle?

PAUL VOLCKER: Inevitably this integration requires some rules, requires some consistency, and a lot of directions, some consistency eventually in monetary policy, among other things. One of the areas [that] has not been the center of my vocation, but I've gotten involved in it because I was asked to do it, [is] some consistency in accounting standards. [It] is important technically that there be some common ground rules around the world for accounting and auditing standards. In this world where international capital flows are so dominant, the reliability and productivity of capital flows depends upon good and consistent information. I also think there is a kind of sub-surface political dimension to this, too, where the United States is viewed, and not entirely wrongly, in thinking that its accounting standards and its auditing standards are the right thing for the world—they're class one and everybody else is class two or three or four. If you don't follow American standards you're not a first-class economic citizen. We do have probably the highest standards and the best standards around the world, but we'd all be better off if we had some internationally agreed [upon] standards instead of standards that appear to be imposed by the United States. Our standards are certainly not perfect, and they're very controversial. The complications of this world require a fresh look at standards, because catching accounting up with reality is not an easy job. The accounting profession has a tremendous challenge in front of them.

What Was Learned from the Latin American Debt Crisis?

INTERVIEWER: We talked a bit about the Latin American debt crisis. When did you first grasp the full significance of that?

PAUL VOLCKER: This had been building up over a period of time. It followed the first and second oil crisis, when the oil producing countries had a lot of money and the poorer countries were particularly hard hit. The banks were flush with cash in the '70s because the oil-producing companies gave them cash. They were looking for places to lend. They decided Latin America in particular, but other developing countries, [too, were a] good outlet for money. There was a lot of competition in lending money and a great laxity in credit standards. And you could see this building up, but it was hard to do something about it. The political climate was not such that you could take any drastic action. This was generally considered good; it promoted economic development in the developing world. But you worried about it. Arthur Burns, one of my predecessors, worried about it a lot and made a couple of speeches [to that effect].

But the process went on, and by the time you got to '81, '82 in Mexico in particular, it seemed pretty clear that they were on a path which couldn't be sustained. They were just borrowing too much money. Their current account was getting deeper and deeper, and at some point that merry-go-round was going to stop. Politically you couldn't do much about it because the Mexican government wasn't willing to recognize it. You could see the crash coming. And it arrived on the doorstep in the summer of '82, when they no longer could borrow money. They ran out of their reserves, and you had a first-class crisis, which immediately spread to the rest of Latin America. And because of the earlier policies, the major banks around the world, certainly including American banks, were very heavily exposed. They had more credits outstanding to those countries than they had capital in some cases. So when [these] countries were unwilling or unable to pay, you had a crisis.

INTERVIEWER: What was the lasting impact of the debt crisis?

PAUL VOLCKER: The lasting impact was disappointingly little in one respect: We went from that crisis into some other banking crises around the world. The banks didn't exactly repeat the experience of Latin America, but they repeated a very similar experience elsewhere. And eventually, of course, you had another crisis in Mexico in 1994, which shouldn't have involved the banking system so heavily but involved a lot of loose credit practices. On the more positive side, it was a very interesting development [for] Mexico in particular, but the other countries faced with crisis did not turn inwards. They took this not exactly as an opportunity but as maybe a kind of warning or signal that they had to open up. These countries had been insular in policies; they had very restrictive trade practices. Their financial institutions were very nationally bounded. In particular in Mexico President Miguel de la Madrid began changing that policy.

And President [Carlos] Salinas de Gortari, with all his later difficulties, advanced it very forcefully and eventually ended up in the North American Free Trade Agreement. So interestingly enough, the sense of crisis and the actuality of crisis pushed those countries away from their old controlled import substitution, isolation policies [and] into the world. It could have gone the other way, but it didn't.

A Look Back on Some Predecessors at the Fed

INTERVIEWER: You said that the role of a central banker is to be as boring as possible. What did you mean?

PAUL VOLCKER: I suppose I meant [to] stay out of the headlines. They're not very successful recently, and we weren't either, but you want to be taken seriously. A lot depends upon credibility and interpretation of your intentions, so you want to be pretty boring, and you'd better be nonpolitical. I suggest being nonpolitical so you'll be as boring as possible. That's not bad advice to a central banker.

INTERVIEWER: [And it's the Fed's job to take away] the punch bowl?

PAUL VOLCKER: That was a famous line of one of my central-banking heroes when I was growing up, William Martin, who was chairman of the Federal Reserve from [1951 to 1970], for I think 19 years. His famous remark was "The job of the Federal Reserve was to take away the punch bowl just when the party is getting good." Now you see what he was conveying is [that] a big boom is nice while it's happening, but it may give you a big headache the next day, and you'd better stop it before it gets [carried away.]

INTERVIEWER: Could one say that Marriner Eccles adds to the great legacy of the Federal Reserve?

PAUL VOLCKER: In a way, Marriner Eccles was the father of the present Federal Reserve. There was a major change in the Federal Reserve Act of 1935 which was largely his handiwork, which strengthened the authority of the Federal Reserve in many respects and in particular the strengths in the authority of the Washington board over the regional banks... So the Federal Reserve had become subordinated during World War II... And interest rates were very low during that period of time, and the Federal Reserve in effect said, "We will undertake the job of maintaining that very low rate of interest as a contribution to the war, and we'll rely upon price controls or anything else to deal with inflation, but we're not going to do it through interest rates." So that policy was continued after the war. Once you got used to it, it was very hard to change it, and it became increasingly controversial, because you did have some inflation after the war, and you had some economic instability, and the Federal Reserve felt they had lost their freedom of action. But it took a long time for them to assert that. Legally they had it, but politically they didn't want to challenge the president and the Treasury.

They finally did in '49 or '50, '51. Marriner Eccles was a leader in that effort. He had not been reappointed as chairman by President Truman. But when it came to an open fight with President Truman, the White House claimed victory. Marriner Eccles released the minutes of the meeting, which clearly showed that the victory was the other way, if there was a victory. That broke the logjam and started the process by which the Federal Reserve did regain its full operating autonomy.

Back to the Books

INTERVIEWER: What was the subject of your senior thesis?

PAUL VOLCKER: The subject of my senior thesis was postwar Federal Reserve policy, "postwar" meaning post-World War II, written in 1948 or 1949.

INTERVIEWER: And did you ever dream that you'd actually end up running a bank?

PAUL VOLCKER: No, I don't think I was that ambitious at that time. In fact, the thesis was rather critical of the Federal Reserve.

INTERVIEWER: And when you were chairman, did you ever dust off your thesis?

PAUL VOLCKER: No, I should have. I was just reading recently a history of monetary policy thought in the United States, which reminded me of my thesis. I'm going to pull out my thesis and see what it said.