NOMINATION OF PAUL A. VOLCKER

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

THE NOMINATION OF
PAUL A. VOLCKER TO BE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

JULY 30, 1979

Printed for the use of the
Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
50-058 O WASHINGTON : 1979

CONTENTS

NOMINATION OF PAUL A. VOLCKER

MONDAY, JULY 30, 1979

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:05 a.m., in room 5302 of the Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Stevenson, Riegle, Sarbanes, Tsongas, Garn, Armstrong, Kassebaum, and Lugar.

Also present: Senator Bill Bradley.

The CHAIRMAN. The committee will come to order. Mr. Volcker, will you rise and raise your right hand.

[Witness sworn.]

The CHAIRMAN. We're honored to have the distinguished junior Senator from New Jersey here to introduce the nominee. Senator Bradley?

STATEMENT OF BILL BRADLEY, U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator BRADLEY. Thank you, Mr. Chairman, members of the committee. I'm pleased to be here with Paul Volcker today before the committee, to which he certainly doesn't need an introduction. Paul Volcker is a New Jerseyite, born in Cape May, N.J., raised in Teaneck, educated at Princeton, a long-time resident of Montclair.

He is a citizen that our whole State is justifiably proud of. His career and his record in the Federal Reserve, in the private sector and certainly the Treasury during the chaotic days of the international monetary crisis in the early 1970's, all these are well known to the committee. That career and record, I think, says that he will be a Chairman of the Fed who is strong, independent and highly respected.

In my view, as in the view of many of our European allies, Paul Volcker is the right man in the right job at the right time. And it's not completely New Jersey chauvinism, Mr. Chairman, when I say that he is probably the best appointment that the President has made.

The CHAIRMAN. Thank you very much, Senator Bradley. I have a statement here from the senior Senator from New Jersey, which I'll read.

STATEMENT OF HARRISON A. WILLIAMS JR., U.S. SENATOR FROM THE STATE OF NEW JERSEY

He unfortunately couldn't be here. He wanted to be here very, very much but there was no way he would cancel the commitment he made. He says—

It's my privilege to introduce Paul Volcker to the Committee and to recommend in the strongest terms possible his confirmation as Chairman of the Board of Governors of the Federal Reserve System.

I've known Paul Volcker on a personal level for many years. He's a native son born in Cape May and educated at Princeton. On a professional level, Paul Volcker has admirers in every country and corner of the world, as a result of his quarter-century involvement in domestic and international finance.

Paul Volcker is welcome to come to our hearing room, having testified before the Committee on countless occasions during his extraordinary career. The Senate should vote to confirm Paul Volcker with all due dispatch. The national and international financial communities have already expressed their strong approval. This is the Volcker rally that occurred last Wednesday. When the nomination was announced, the stock market rose 10 points and the dollar moved ahead in foreign markets.

I read this as a vote of confidence and proof positive that Paul Volcker possesses all the experience and expertise necessary for understanding and solving the complex problems now facing the U.S. and foreign economies. Speaking for myself and the people of New Jersey, we are pleased that Paul Volcker's past accomplishments to the nation have been recognized; he has once again at some personal sacrifice obeyed the call for even higher and more difficult service to his country.

Does any Senator who is present desire to make a statement before we proceed to the questioning of the witness?

[No response.]

The CHAIRMAN. If not, Mr. Volcker, do you have any statement?

Mr. VOLCKER. I do not, except to say it is a great honor and privilege to have the President nominate me for this post. I can only promise to do my best, if the Senate sees fit to confirm me.

I might say that I'm particularly conscious that the Federal Reserve has a great reputation, I think, for integrity and professionalism, and it would be my wish that that tradition could be further advanced.

The CHAIRMAN. Because of a technicality, I'm going to have to ask unaminous consent from the committee to waive the so-called 5-day rule. Committee procedures require that hearings on a nomination not be held until at least 5 days after the committee's financial questionnaire has been received. We received Mr. Volcker's completed questionnaire last Friday; however, in view of the importance of this appointment and the need to have Senate action prior to the August recess, I ask unanimous consent that the 5-day rule be waived.

I take it there's no objection.

[No response.]

The CHAIRMAN. Mr. Volcker, we're most impressed, I'm sure, by what Senator Williams and Senator Bradley has said and by your obvious qualifications. It's great to have a nominee for the Federal Reserve Board who has devoted most of his adult life to the Federal Reserve System. As a matter of fact, I understand you started with them when you were either out of college or just before you got out of college.

Mr. VOLCKER. Right after I got out of college, I took a summer job with the system before graduate school, that's right.

The CHAIRMAN. You've had other experiences, of course. You were a vice president of the Chase Manhattan Bank. You were, of course, a top official in the Treasury under, I think, three different administrations, three or four, dealing primarily with monetary policy as I understand it.

You've written and spoken on the issue many times. There's no question of your competence and your experience. I think, however, to many people in the country, you may be the personification of Wall Street and international banking.

It isn't always a favorable view, as you know. You're viewed as a hard money, big business conservative. What's your answer to the fear that in the immortal words of William Jennings Bryan you may choose to "crush down upon the brow of labor the crown of gold," by pushing high interest rates to levels that would be punishing and create more unemployment and be very difficult for small business, the farmer, and the working people.

Mr. VOLCKER. Let me say thus far, the great bulk of my career was spent one way or another in the public service, as you pointed out. And to some extent I will have to let that record speak for itself. I do think this country faces great problems. I have spoken out and I expect to continue to speak out on the need for stability, broadly conceived—thinking of it in terms of our domestic inflation, thinking of it in terms of the value of the dollar internationally.

I speak out of a very strong conviction that this sense of stability is necessary in order to assure the prosperity and growth of our economy at home and to deal with those problems of unemployment, poverty and all the others. I don't think we can build on a sense of instability—accelerating inflation, instability of the dollar abroad—if we want to deal constructively with those problems of the domestic economy.

For that purpose, I don't want interest rates any higher than they have to be. Indeed, I think the broad record of history is quite clear that the level of interest rates is very specifically related to the level of inflation, and if we want low levels of interest rates—which I think would be desirable—we have to recognize that that's not going to be feasible until we have a more stable economic and financial climate.

The CHAIRMAN. It's a perplexing and difficult problem for us. The Fed, some critics say, has had a long record of boneheaded decisions in contracting the money supply in the thirties, expanding it in the seventies, when we seem to be moving ahead and suffering primarily from inflation. Now, with a recession upon us, we confront the same penchant in the view of some people.

In March and April, you voted with the minority on the Open Market Committee for a policy that would result in tightening credit. Now you'll be the top man at the Fed, with more influence than ever.

Does that mean we enter this recession with the likelihood of a tight monetary policy and possibly interest rates at an even higher level?

Mr. VOLCKER. I don't think it's appropriate for me to comment on what particular moves might be necessary or desirable in the near future. I'm only one member of the Federal Reserve Board, if

I'm confirmed; I'm only one member of the Open Market Committee.

I would point out, with respect to very recent developments, that the money supply, the money aggregates generally have been rising at a pretty good clip, and I don't think there's any feeling or any evidence around at the moment that the economy is suffering grievously from a shortage of money.

The CHAIRMAN. Dr. Arthur Okun, who as you know, is a former CEA Chairman and a highly respected economist, had an article in the American Economic Review recently in which he took six studies made since the Korean war, and he found that when the Fed had tightened the money supply, reduced the rate of increase in the money supply, that it had resulted in a reduction of the rate of inflation, but the price had been very high, that 90 percent of the reduction in the gross national product had been in production of jobs and only 10 percent in price, varying from 6 to 15 in the 6 studies that he analyzed.

In other words, the price that had to be paid in tightening credit was a terrific price in the loss of jobs and the loss of production. Now admittedly, as he said, that was the first year, but he felt on the basis of that study there's some evidence that this may not be the way to cope with inflation.

What's your response to that?

Mr. VOLCKER. I'm not familiar with that particular study, but I'm familiar with econometric studies which show, particularly in the very short run, that the response of the inflation rate to a slackening in economic activity is not very quick or rapid.

I think we have to be very careful about the implications of studies of that sort. I think we're all familiar with the fact that today we have both a high rate of inflation and, speaking broadly now of the 1970's, a less satisfactory performance in terms of unemployment, in terms of productivity, in terms of growth. And part of the difficulty—and part of what has helped to account for this—seems to me the fact that the prolonged nature of the inflation has changed expectations, it's changed the way people look at their personal lives, and view the outlook for the economy, in an unfavorable way.

We've ended up, if not with the absolute worst of both worlds, with a lack of progress both on the inflation front and on the employment front. I think that is symptomatic of the fact that we cannot consider these over a period of time as opposing goals, but we have to work toward them together, and that they're mutually complementary over a period of time.

And we have to consider the short range tradeoffs, if you will, in that longer term context. Indeed, I think it's fair to say the economy probably doesn't react the way you and certainly I were brought up to think. In terms of economic analysis, we were taught that an expansionary dose by whatever technique would improve employment with maybe some risk of inflation. We proceeded on that assumption for a long time, and we found the risks of inflation become much greater and that reactions in terms of employment, output and productivity get less.

I think that reflects a change of psychology on the part of the American people in general that we have to take into account. It's perhaps symptomatic of some of the new problems and, indeed, the new opportunities for economic policy that we find some evidence recently that actions that are interpreted as dampening the inflation rate have a favorable impact on the climate of financial markets—the long-term interest rates will decline instead of going up—whereas actions that are interpreted as inflationary, which may include easier money in some specific instances, have a rather perverse effect on financial markets that is counterproductive.

I don't think we have any substitute for seeking an answer to our problems in the context of monetary discipline. Now, that's not at all to say that monetary policy alone can handle this problem. Many other factors in Government policy and elsewhere enter into this equation, and the more help we can get from those other policies the better off we're going to be.

The CHAIRMAN. Might it also not be true that some of those other policies, incomes policy perhaps, fiscal policy, might be more appropriate and logical than monetary policy in a period such as this? I notice also, I was just talking to Mr. Okun on the phone and he pointed out to me that during this period we had a big contribution in rising inflation because of the way the Consumer Price Index is constructed—in the way increases in interest rates themselves are treated in the CPI. They were one of the major reasons for inflation to be exacerbated.

Mr. VOLCKER. I think it's an exaggeration to say higher interest rates were one of the major reasons, but there's no question that the level of interest rates paid by consumers enters into the Consumer Price Index, all other things equal. A rise in mortgage rates contributes to that index's performance at a particular period in time. But I would suggest, again, that if we don't deal with the inflation problem in its overall context, I unfortunately don't know of any way you can keep interest rates as low as they used to be.

The CHAIRMAN. My time is up. Senator Garn?

Senator GARN. Thank you, Mr. Chairman. Mr. Volcker, I'm pleased with your nomination by the President and I appreciate your call to me on last Friday and the discussion that we had.

I'd like to follow up on that telephone discussion of one of the principal concerns I have about the Federal Reserve system and that is its independence. In the 5 years I have been on this committee, I have not always agreed with the Federal Reserve's policies and decisions. Sometimes I will agree with the Chairman that they have been wrong, at least from my point of view. Nevertheless, I think it is highly critical and important that the Fed have the independence to make its own decisions away from undue influence by this committee or the Congress or the administration, because we tend to politicize the fiscal policy of this country and to politicize the monetary policy only adds to the burden of inflations and deficits and economic problems of this country.

So I'm vitally interested that you, as Chairman be willing to be very blunt, very candid, if you think we are wrong, when you disagree not only with us at the Senate Banking Committee, but with the President.

Once again, even though I may not always agree with your actions when you become Fed Chairman, I do think the Federal

50-058 O - 79 - 2

Reserve Board was set up to be independent, to serve as a check and balance on both Congress and the administration. And I think generally it has worked very well over the years.

So, I would appreciate your expression of how you feel about this particular subject and your role as Chairman of the Federal Reserve Board and the relationship with Congress and the President.

Mr. VOLCKER. I have a deep commitment to the independence of the Federal Reserve as you describe it, Senator. I think we are the creature of the Congress and Congress decided, in 1913, to set up the Federal Reserve in a way that gave it some insulation from the kind of political pressures that you described. They reexamined the Federal Reserve in 1935, and reiterated, very wisely in my opinion, that fundamental decision; and that is the law as it stands today.

I feel both comfortable and clear in my mind as to the role of the Federal Reserve in that respect. I think it is consistent with all the discussions I've had preparatory to taking this job.

Senator GARN. In the President's televised news conference last Wednesday, he said he felt that the dollar was sound and he said that you, referring to you as an expert on monetary systems, are a person on whom he can depend. With respect to your appointment, he said that "there is no doubt that you would work harmoniously with me and Bill Miller, who will be the new Secretary of the Treasury, and I believe this new team will be very effective."

Now, I don't want to read too much into that statement, but it does disturb me a little because of my strong feelings about the independence of the Fed, particularly its Chairman. The President's reference to you, Mr. Miller, and himself as a team is interesting. In keeping with this analogy I would suggest that as the first-string monetary policy quarterback, that you insist on calling your own plays.

Mr. VOLCKER. I agree with that. Ultimately I think that the decisions on monetary policy are those of the Federal Reserve, and we have to call the shots as we see them. That is not inconsistent in my mind with maintaining communication—communication with this committee, with the Congress in general, with the administration. I don't think you can run policy in a vacuum in that sense, but I want to be clear and reiterate that the ultimate decisions on monetary policy are those of the Federal Reserve, and they might clash at some point with what an administration or what this committee might think is appropriate in particular circumstances. I think that is inherent in this position. We can communicate; we should communicate as fully and freely as possible. But when it comes to the ultimate decision I think the law and tradition is quite clear.

Senator GARN. I would agree with you completely that communication is necessary. How would you describe the type of relationship you expect to have with Bill Miller and with the President?

Mr. VOLCKER. I've observed this process firsthand for a number of years, from various vantage points running back certainly to the early 1960's, and there have been a number of arrangements over the years with Secretaries of the Treasury or other Treasury officials and Chairmen of the Federal Reserve or other members of the Federal Reserve meeting with each other on a regular basis, once or twice a week. There has been in other administrations an institution, the so-called quadriad, where the Chairman of the Board of the Federal Reserve occasionally discussed mutual problems in a group including not only the Secretary of the Treasury, but the Chairman of the Council of Economic Advisers and the Director of the Bureau of the Budget.

In recent years, the Council of Economic Advisers had occasionally met informally not only with the Chairman, but with other Federal Reserve Governors. There are various techniques for maintaining open lines of communication that I think are valuable.

Senator GARN. When the President or others in his administration spoke with you about this nomination, did they indicate an awareness of the independent status of the Fed?

Mr. VOLCKER. I think that awareness was very clearly expressed on both sides.

Senator GARN. So that was no indication that they expected you to be part of the administration or expected to assist in carrying out the administration's economic program?

Mr. VOLCKER. No. I think we have common goals in the functioning of the economy, but not in the sense that I think your question may imply.

Senator GARN. Well, I agree and I don't mean to imply anything except to stress over and over again—as I have served here for 5 years, in what I consider an absolutely fiscally irresponsible Congress—one of the reasons I feel that inflation would be much worse without the restraint of the Fed, and why I'm so vitally concerned that it remain independent and not yield to the pressures of Congress or this administration, I don't mean to single out this administration, any administration——

Mr. VOLCKER. No, exactly. Obviously there have been incidents in the past where the administration and the Federal Reserve have seen things somewhat differently. The other side of the coin is, I suppose, that our job is made much more difficult depending upon what an administration or a Congress does. Communication is important so that we can explain our own views on other policies that may make our job easier and less a source of contention.

Senator GARN. A little over a week ago, the House passed the so-called Fed membership bill, H.R. 7, defining the voluntary nature of present membership and the safety mechanism of universal reserves. Universal reserves would be imposed under H.R. 7 if the percentage of deposits subject to the Fed's reserve setting authority under the voluntary approach falls below 67½ percent, then it would become mandatory.

This was the compromise amendment proposed by Congressman Stanton, endorsed and passed in the House by a rather large majority, 340 to 20, and I would just like you to explain what your opinion of this approach to the Fed membership problem is.

Mr. VOLCKER. Let me say, first of all, I do think that this is a critical problem for the Federal Reserve, for the strength of the Federal Reserve, for its ability to carry out its mandate over a period of time, and I hope with some urgency that this problem can be resolved this year.

I don't want to—and I'm not competent to get into—all the details of this issue in commenting on that bill as it emerged from the House of Representatives. I obviously have been following the issue in a general way; in fact, I testified before this committee a couple of years ago on the problem in general.

That that bill leaves me with some questions, let me put it that way, on some particular points, but my impression is that it also may provide a basis for constructive legislation. I would hope to come back to the committee shortly and give you more detailed comments on the direction in which we might go.

Senator GARN. My time is almost up, but let me just follow that up with one more question. In 1977 you testified before this committee on the Financial Institutions bill S. 1664. You stated that interest payments on required reserves would permit a direct impact on the membership burden, indicating the financial burden of Fed membership, and that this approach seems to be superior to other possible solutions.

Do you still advocate that kind of approach?

Mr. VOLCKER. That was my view at the time. I still think it's an attractive approach. The House has gone off in another direction. I think there are alternatives to that approach, and whether the idea of interest payments should enter into this final proposal in some way is still very much an open question in my mind and one I want to return to when I look at that bill in detail.

Senator GARN. Of course the House and Senate have gone in a different direction. I would agree with your 1977 position and Bill Miller's 1978 position on interest and reserves.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Stevenson.

Senator STEVENSON. Thank you, Mr. Chairman. Mr. Volcker, I welcome your nomination for, among other things, your grasp of many of the international conventions on monetary policy.

Would you comment on the dollar's recent weakness and what, if anything, the Fed should be doing to support the dollar?

Mr. VOLCKER. Let me put that in a little broader context, if I may, Senator. Beginning in 1977 really—and running through the early autumn, anyway, of 1978—the weakness was very pronounced, as you recall. A program was introduced on November 1, 1978, directed in part toward this problem, directed also toward domestic inflation, which I think lies behind this almost chronic weakness in the dollar that we've had recently.

I was very much in support of that kind of a program. Indeed, I think the program is desirable on domestic grounds as well international grounds.

Since that time, the dollar, in broad terms, has been much more stable. It went up for a while, and now, as you point out, most recently it has shown some weakness but that weakness is not of the order or magnitude that it was earlier; I just want to note that and keep it in perspective.

I do think that the dollar got too low considering all the circumstances last fall and it is damaging both to our domestic prospects and to the international economy. Indeed, I think it's damaging, in a broader sense, to the whole stance of this country in the world to be operating with an excessively weak dollar. So I think it is important to maintain stability in that relationship.

The most fundamental thing we can do about it, without question, is to deal with internal inflation. There isn't any answer over a period of time without looking toward the conditions of the internal economy. I think we also have to be sensitive to relationships that develop in the market from time to time, and respond to them as appropriate, which depends upon a whole host of considerations: the specific international situation at the time, the situation with the domestic economy at the time. It's very hard to give a general answer suitable to all circumstances.

Senator STEVENSON. I didn't expect you to give a very specific answer, but I'd hoped that you could do a little bit better than that. You said inflation is behind the weakness of the dollar. Is it also true that the weakness of the dollar is behind inflation?

Mr. VOLCKER. That is right. And, obviously, energy is a major ingredient in this whole thing, and the more effective our energy programs, the better off we'll be.

Senator STEVENSON. The Chairman brought up interest rates not very long ago. You indicated that high interest rates do go directly into the consumer price index. High interest rates also retard investment and reduce productivity. They don't increase our capacity for production for such services as housing. They have other effects on inflation beyond those which you mentioned, but I question how much control the Fed really has over interest rates.

It never has had much of a long-term control over interest rates, and I wonder now if it isn't reducing much of what little control it has over short-term rates. I say that because of the growing evidence of efforts by central banks to stabilize exchange rates, to support their currencies, and perhaps to reduce the price of oil by diminishing the value of the dollar. You get into a circularity which always pushes rates up and rarely down. One country goes up with the discount rate, the others have to follow suit, then the first country goes up again.

Isn't that phenomenon taking place right now, and if that kind of artificiality is intruding into the process, what should be done about it?

Then what would you, as Chairman of the Federal Reserve Board, do to initiate some cooperative efforts with others in similar position to reverse that process?

Mr. VOLCKER. Let me say in general, Senator, I think it's very easy to exaggerate—and it usually is exaggerated—how much control the Federal Reserve has over interest rates, primarily for the reason I expressed earlier that interest rates are bound to be related to the rate of inflation in the country. While interest rates now are very high in nominal terms, we'd better put those interest rates in the context of an 11 percent mortgage rate or an increase in the Consumer Price Index at an annual rate of 13 percent the first half of this year. And I'm sure the rate of housing prices is going up even more rapidly than that. So interest rates don't look so high in that context, in a real sense.

Now in this international dimension, I think you have pointed to a potential problem. I am not sure that I would go quite as far as you did in saying that this is a major problem at the moment, when we have a general economic background of rising inflation in most countries and fairly buoyant business conditions in most other countries; they have a combination of rising inflation rates and rising economic activity.

It's not unnatural or abnormal, in a period of that sort, to see some increases in interest rates, but there is a problem potentially—or recurrently, if one projected ahead—of the kind that you suggest. Given the impact of the oil situation and the potential impact of the oil situation on economic activity, not just in the United States but in other countries, I think it's very legitimate to raise the question that you raised looking down the road not all that far.

I don't know of any mechanical answer to the question other than that I think it's important that we remain in contact with the monetary authorities abroad; that this kind of problem is discussed, as it is to a degree; that we don't get into a self-defeating or artificial chasing of the tail where counties—not because of their domestic situation and not because of the real economic situation—engage in the kind of competition that you mentioned.

Senator STEVENSON. Your testimony is more soothing to the bankers than it is to me, Mr. Volcker. Don't you see anything abnormal about going into an international recession with interest rates at 10, 12, to 15 percent?

Mr. VOLCKER. I think our economic situation is abnormal.

Senator STEVENSON. That's part of the problem.

Mr. VOLCKER. I certainly agree with that. Again, it's abnormal in terms of all our history. You say going into a recession; I think there is a clear danger there. It remains to be seen just how severe that will be, and whether, in fact, in the end, this will prove to be a recession. I certainly recognize the risk and the clear possibility that that is the case. But what's abnormal is that we're going into it with an inflation rate of the sort we have. That's what's unprecedented, and I think that the interest rates are a byproduct.

Senator STEVENSON. Isn't it true that banks right now, central banks abroad, are quietly undermining the dollar in order to reduce oil costs?

Mr. VOLCKER. No; I think that is not true.

Senator STEVENSON. I've heard that from a central banker who is doing it.

Mr. VOLCKER. That seems to be an exaggerated statement. I think some foreign countries have found in recent years that an appreciating currency is not altogether bad in that, among other things, it is a rather powerful influence on maintaining domestic price stability in general and on reducing their oil import bill, in particular.

For that reason, I think a number of important countries would not look happily upon a major depreciation of their own currency. I keep looking at the overall international situation. There are very few foreign monetary officials who are not disturbed by the general instability that is associated with a significant decline in the dollar, and I don't want to deny that you've put your finger on a problem, in an underlying sense, of international monetary reform that has preoccupied us for years in one guise or another.

In effect, we had something of the opposite problem in the early 1970's when I think the general feeling was the dollar was overvalued, but a number of countries were not very eager to see their old competitive position—which had built up over a period of time and became embedded structurally; it had some advantages to it—

undermined very rapidly. Now the psychology is somewhat in the other direction, but the general problem remains of developing a system and a consensus that in practice reconciles these differences in approach—or instinct perhaps—in a harmonious way.

There is no automatic way to do that that I know of under present conditions, but I also don't want to exaggerate the difficulties here, because I do think that there is a feeling of a common interest in a more stable system.

Senator STEVENSON. Thank you. My time has expired.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Armstrong?

Senator ARMSTRONG. Thank you, Mr. Chairman. Could you tell me, Mr. Chairman, what your timetable is for acting on this nomination?

The CHAIRMAN. Yes, we have a 2-day rule, as you know. I think we simply have to abide by that. We'd like to waive everything we can, but obviously members have a right—and some members here want to read the transcript. I consider it the most important nomination that I think this committee will have this year, perhaps the most important nomination, in many respects, the Senate will face. So it will be Wednesday; Wednesday we will report to the floor. We will poll the committee unless there's objection. I don't anticipate there will be.

Senator ARMSTRONG. Mr. Chairman, there may be an objection to that procedure, and let me at the outset explain why. And Mr. Volcker, this has nothing to do with you or your qualifications, but I'm concerned, as a matter of policy, that someone would be appointed to a position which you correctly underscore the importance of, and in a very brief time whose name would be submitted by the President, come before this committee in 2 or 3 days, and then be presented to the Senate and be confirmed. If there's meaning and purpose in this process of holding these hearings, it is in part to give the country—the people who aren't in this room today—a chance to comment on appointments. It may be that I will object to acting with such speed, even though I'm also conscious of an August recess, and that's something I'd like to chat with you about, perhaps in the next day or so.

The CHAIRMAN. You wouldn't object, though. I don't think an objection would be in order to a meeting of the committee on Wednesday.

Senator ARMSTRONG. Of course not.

The CHAIRMAN. If you want that, we'll meet on Wednesday and the committee will——

Senator ARMSTRONG. Well, I will follow up with you on that. And Mr. Volcker, I stress that my concern is for the practice and the custom, and perhaps we can find a way to accommodate that.

Mr. Volcker, I join with the others in welcoming you to the committee, and I have several questions I'd like to raise. Obviously, the job to which you've been appointed has a tremendous impact on the day to day life of the country. Possible the most important aspect of the job is the control of the money supply which has been under discussion here this morning.

I'd like to ask a couple questions. First, do you feel that the Federal Reserve has sufficient ability and power to actually control the growth of the money supply?

Mr. VOLCKER. I think it's threatened, frankly, Senator. It's threatened by two things. One is this so-called membership question that we referred to earlier. I'm not sure that that has eroded our ability to the point where I can make the case that it's seriously undermined our powers yet, but it is latent in that situation.

Senator ARMSTRONG. Let me be a little more specific. If the Governors sit down around the table and after weighing all the economic evidence, decide they want the money supply increased in the next quarter or the next 6 months or the next year by 3 percent or 4 percent or 5 percent, if they say look, our target for M_1 is so and so or for M_2 is so and so, do they really have the ability to fine tune it and to adjust it?

Mr. VOLCKER. If you're talking about the next quarter, my answer is no.

Senator ARMSTRONG. How about the next year?

Mr. VOLCKER. In the next year, my answer generally would be yes, again with the qualification that I was about to express. These days financial markets are very innovative, and we find forms of money or near money springing up—almost monthly, I suppose—that are outside of our direct control, that leave some fuzziness surrounding the concept of money itself. We are at a stage where we're reexamining the definition of money. I'm not sure there is a permanent answer to that question. In fact, I don't think there is, because money depends upon a functional definition, and the functions of instruments in the marketplace change.

In general, I think if our sole attention were directed toward affecting a number we pick out as the money supply, we could come pretty close to that number in a year's time, or maybe less than that. We can't, in a quarter's time——

Senator ARMSTRONG. In the time available, I guess I'd like to boil it down to this. Is it your feeling that the Fed is able to control the money supply to a degree that is sufficient to hold down the inflation rate, if it chooses to pursue that policy?

Mr. VOLCKER. Yes, at present. I think the real question is whether you can or should do this using money supply policy alone. Money supply has an absolutely indispensable role to play here. How easily that process of skewing down the inflation rate goes will depend upon a lot of other policies in addition to the money supply policy.

Senator ARMSTRONG. Mr. Volcker, in response to the chairman's question about that, you declined to be very specific on how you would exercise this responsibility and whether or not, in fact, you'd like to slow the rate of growth of the money supply.

Mr. VOLCKER. Yes, I would; that is, over a period of time.

Senator ARMSTRONG. You would like to slow it down.

Mr. VOLCKER. Over a period of time, it's indispensable that we do that if we're going to have price stability. Let me look through some of the definitional problems at the moment. I think the relationships are good enough that if the growth of money is excessive over a period of time, we're going to have inflation, and there's no way——

Senator ARMSTRONG. What would you characterize as excessive in the long term?

Mr. VOLCKER. When I put an actual number on it, I do get into definitional problems. Look at the narrow money supply, M_1. I think old relationships would suggest, if we're really going to have price stability—I'm going all the way now to a noninflationary situation—we would not have very much growth in that particular number, based upon the standard historical relationship, because there's been a general tendency over the years for velocity to increase; money turns over a little more rapidly. So you have real growth in the economy at whatever rate—3 percent, hopefully more—but you can take care of most of that real growth through an increase in velocity, if you look at the narrowest definition. As I also suggested, those relationships may be changing, and we may need to modify the definition of money.

Senator ARMSTRONG. Without being too specific, is that the general policy that you favor?

Mr. VOLCKER. Ultimately, yes, I would like to get there. I'm not going to get there tomorrow.

Senator ARMSTRONG. Well, let me ask this question. Since the statutes require that the Federal Reserve support Treasury bondage——

Mr. VOLCKER. The statutes require——

Senator ARMSTRONG. It's my understanding that ultimately you're required to support the debt issues of the Treasury. Am I mistaken about that?

Mr. VOLCKER. I think the law is quite clear that there is no direct relationship between the Treasury and the Federal Reserve in that area. It was one of the principal concerns, I think, in the authors of the Federal Reserve Act that there not be that kind of direct relationship.

Senator ARMSTRONG. Has the Federal Reserve ever declined to support a Treasury issue?

Mr. VOLCKER. Yes.

Senator ARMSTRONG. Thank you. I appreciate that, and that's something I would like to be better informed on. My impression was that that is nearly an automatic process.

Mr. VOLCKER. No, not at all. In fact, except for limited instances, the Federal Reserve is prohibited from directly buying Treasury issues from the Treasury. Of course, we do buy them; we're in the market all the time, because it is the instrument with which we pursue our monetary policy with an eye primarily toward the money supply. But we have no obligation to support particular Treasury issues.

Senator ARMSTRONG. Could I raise a couple of personal issues? Would it be your intention, if confirmed, for this appointment to remain in the job through the term?

Mr. VOLCKER. Yes.

Senator ARMSTRONG. May I ask, in your résumé you mention that you have published a number of articles, and at least at the time of the preparation of that résumé, a list of them wasn't available. Could you give us at least an outline of some of those things and where we could get hold of those in the next day or two,

50-058 O - 79 - 3

so that if we would like to read them—I really would like to read some things just to get the flavor of your general economic theory?

Mr. VOLCKER. I think the easiest thing is for me to send all my speeches and articles of the last few years.

Senator ARMSTRONG. It would be very helpful.

I'm concerned, as other members of the committee are, about the issue of the independence which you would be able to exercise. May I ask, when you were first approached by the administration to undertake this job or to discuss doing so——

Mr. VOLCKER. I don't remember the precise date now. Mr. Miller called me one day—I suppose it was Monday—just to talk about my feeling about names in general.

Senator ARMSTRONG. Did you say Monday or one day?

Mr. VOLCKER. Monday, I believe. I talked to the President on Tuesday, if I recall correctly, and on Wednesday he talked to me again.

Senator ARMSTRONG. A week ago?

Mr. VOLCKER. A week ago, yes.

Senator ARMSTRONG. Was there anything in your discussions with the President, Mr. Miller, or others that would in any way compromise your independence? Was there anything asked of you?

Mr. VOLCKER. Absolutely not. Quite to the contrary, I think there was an understanding of the particular role of the Federal Reserve.

Senator ARMSTRONG. So that you would be able to undertake this task in a completely independent manner?

Mr. VOLCKER. Absolutely.

Senator ARMSTRONG. Thank you very much. I compliment you on what you have said and, Mr. Chairman, I yield back my time. I have a couple of questions which I perhaps would like to submit to Mr. Volcker and ask that they be incorporated in the record.

The CHAIRMAN. Very good. Without objection, you can answer those when you correct your remarks.

[The following information was received for the record:]

MR. VOLCKER'S ANSWERS TO QUESTIONS OF SENATOR ARMSTRONG

Question (1.a.). Many economists believe that we are now beginning a stagflationary cycle. Inflation is well into the double-digit range while real growth in the economy appears to be grinding to a halt. Under the circumstances, what do you consider to be prudent monetary and fiscal policy?

Answer. Under present circumstances, I believe a prudent monetary policy is broadly reflected in the ranges for monetary growth recently adopted by the Federal Open Market Committee and discussed with your Senate Committee last week. Because current problems stem in substantial part from inflation and inflationary expectations, I believe we cannot prudently depart from disciplined monetary growth without jeopardizing in a still more serious way prospects for future gains in employment and productivity. I also believe the budget should be brought into balance as soon as possible, but what is possible and prudent in the short run will depend on business developments. As I suggested yesterday, a broad program of tax reduction at this particular time seems premature. I believe that this is even more true of expanded spending programs, which might add to the difficulty of achieving budgetary balance.

Question (1.b.). What extent, if any, do you believe the federal budget deficits constrain efforts to reduce inflation?

Answer. Federal budget deficits, other things equal, bring pressures on financial markets and in some conditions may inhibit productive investment by the private sector. For both reasons, budget deficits may make it more difficult to reduce inflationary pressures both in the long and short run. However, the speed with which we can move toward budgetary balance will depend on, among other things, shorter-range business trends.

Question (1.c.). You mentioned in your testimony that it was your personal goal to slow the rate of growth in the money supply to near zero while accommodating real economic growth through increased monetary velocity. How soon do you expect to implement this policy? Over what period of time would you expect to achieve this goal?

Answer. You may recall that I noted that a very low rate of monetary growth would be consistent with overall price stability. Under present circumstances, that condition must be considered an objective that can be reached only over a period of years and toward which we should move in prudent steps. The speed with which we can move will depend in considerable part on the strength of price and cost pressures arising from other economic forces. We can begin to move in that direction, but I cannot now reasonably suggest a precise date for reaching the objective of essential stability in the stock of money and the general price level.

Question (2). While your served at the Treasury Department, you managed the policy of demonetizing gold. At the time, did you foresee that the price of gold would increase from $35 per ounce to more than $300 per ounce? In retrospect, was this policy wise? Do you foresee circumstances under which the United States might return to metallic backing for its currency? Would you favor or oppose such a change?

Answer. I should note first that the process of demonetizing gold began before I served at the Treasury Department and continued after that period of service. In any event, I cannot say that I foresaw a price of gold at $300 per ounce. I can say, and have always thought, that the combination of domestic inflation and instability of the dollar internationally could prove unsettling in terms of both expectations and economic performance. In retrospect, I believe a change in the value of the dollar was necessary in the early 1970s. However, insufficient attention was paid to the importance of damping inflationary forces arising during that period from a variety of sources, among which the effects of the changes in the value of the dollar through the devaluations of 1971 and 1973 were relatively minor. I do not foresee circumstances under which the United States would return to backing the dollar by gold, and I would not favor such a change.

Question (3). Last November, President Carter initiated the dramatic "dollar rescue program." This forced the United States to borrow from the International Monetary Fund for the first time since World War II. As a result, the United States will have to issue bonds denominated in foreign monies. This is a critical benchmark in our economic history. At the time, many thoughtful people predicted the program would ultimately fail. They may be right. The dollar is weak on foreign exchange markets. Inflation continues unabated at double-digit levels at home. In the past three months, monetary aggregates for the Federal Reserve have exploded past its own targets. In light of this evidence, do you believe the President's program is sound?

Does the program reflect that the United States has forsaken its role as the world's economic leader?

As Chairman of the Federal Reserve, what would you recommend to strengthen the dollar abroad and reduce inflation at home?

In light of the sharp monetary expansion, does it indicate that the Federal Reserve has not placed an appropriately tight rein on money supply?

Answer. As I indicated yesterday, I was in full sympathy with the program undertaken last November. It was desirable in light of the inflationary situation at home and the instability of the dollar abroad, and it was fully consistent with appropriate domestic economic policies. Obviously, the particular steps taken at that time do not provide in themselves an adequate program for the future. Monetary, fiscal, and other measures need to be kept under continuous review, but I do believe the general direction and tenor of the measures taken were sound. And I do not believe that these actions were in any way contrary to the role of the United States as the world's economic leader. In fact, they supported that role.

In regard to measures to strengthen the dollar abroad and to reduce inflation at home, I have touched upon those concerns in my testimony yesterday and in my answer to question 1 (above). I would emphasize again that a successful attack on inflation and on our external problems will require actions and programs that extend beyond monetary and fiscal policies. Quite clearly an effective energy program must be an important ingredient in any solution, and I am very conscious of the strong cost pressures arising both in the private economy and directly and indirectly from a variety of government programs.

As you noted, there has been a sharp monetary expansion in recent months. I would point out, however, that the period of rapid growth has been rather short.

Taking the first and second quarters of this year together, there is evidence of some moderation in monetary growth. I am sure that the Federal Reserve will continue to monitor developments closely and take those actions necessary to keep monetary growth within appropriate ranges.

Question (4). The press recently reported an economic minister in a major Euopean government saying, "I hope that whoever becomes dominant will pursue a conservative monetary policy, and not delude themselves into thinking they can float the United States off its difficult energy and other economic problems by adopting an inflationary policy." What is your reaction to this advice?

Answer. As I have stated, I find myself in broad agreement with the sentiment expressed in the quotation. It would be an illusion to believe that we can resolve our present dilemmas and difficulties by permitting inflation to accelerate or even by maintaining the current rate. I believe that ultimately the only sound foundation for the continuing growth and prosperity of the American economy is much greater price stability.

Question (5). Although the Federal Reserve has no direct responsibilities for tax policy, the Chairman of the Federal Reserve has influence on all economic decisions. Therefore, I would appreciate knowing whether you (1) favor utilization of the tax code to achieve income redistribution? (2) favor major tax reductions this year for individuals and corporations? (3) favor faster depreciation allowances and postponement of Social Security tax increases to spur economic growth?

Answer. (1) The tax code has over a great number of years been used in part to achieve some income redistribution and I would expect that that objective will remain relevant. But also I believe we have learned that there are limits on the extent to which the tax code can be used for that purpose consistent with the achivement of other objectives.

(2) As I indicated yesterday, I believe consideration of tax reductions at this point is premature.

(3) Should circumstances arise in which tax reductions appear desirable—and over a period of time I hope such circumstances will arise—I believe attention should be given to both faster depreciation allowances and some method of achieving relief from heavy payroll taxes which tend to contribute to cost and price pressures. Obviously before a decision could be reached, other desirable tax changes would also need to be reviewed, and I recognize the importance of maintaining some relationship between social security taxes and benefits.

Question (6). The follow up on a question I asked earlier today. I understand, the Federal Reserve is limited by law to the amount of U.S. Securities it can purchase. The Federal Reserve, however, often works in concert with the Treasury to create favorable conditions to enhance the marketability of these securities. If that fails, the Reserve can, up to its statutory limits, purchase either directly or indirectly, those outstanding securities. Is it appropriate for the Federal Reserve to work in concert with the Treasury Department to create a financial climate favorable to enhance purchase of U.S. Securities? To what extent, if any, does this responsibility conflict with your advocacy of slowing the rate of growth of the money supply?

Answer. You refer to the Federal Reserve working in concert with the Treasury to create favorable conditions to enhance the marketability of Treasury securities. While that comment may be relevant to some earlier periods of history, particularly in the period of World War II and its aftermath, I do not believe that it is a fair characterization of relationships in recent years. There are very strict limits, recently reinforced, on the ability of the Federal Reserve to purchase securities directly from the Treasury. While the Federal Reserve does purchase Treasury securities in the open market, such purchases (and sales) are arranged in a manner to achieve the objectives of the Federal Reserve with respect to monetary policy rather than to meet the convenience of the Treasury in marketing its securities. The Federal Reserve does of course consult with the Treasury Department about its financing activities, and I would expect such consultation to continue.

As I suggested in my answer to your first question, a heavy supply of Treasury securities on the market can influence adversely the climate in financial markets generally and to some degree would be taken into account by the Federal Reserve in arriving at decisions on monetary policy. That is one important reason why I would like to see the Federal budget deficit eliminated over a period of time.

The CHAIRMAN. Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Volcker, following up with some other conversations we've had, I gathered from your earlier response that you're not convinced yet that we are in a recession.

Mr. VOLCKER. No, but I think there is a reasonable chance, certainly.

Senator RIEGLE. You know it's very interesting——

Mr. VOLCKER. Let me say that I think a very important factor in our present situation has been the oil situation. This is, in the short run, bound to be a bit of a knock to the economy, and some of the particularly depressing figures recently, I think, stem rather directly from that situation. I think, in particular, the automobile industry——

Senator RIEGLE. I'm concerned about that, too. There's an item in the Wall Street Journal today reporting a very substantial additional layoff by General Motors, which has been one of the stronger domestic companies. But it's interesting that the outgoing Chairman of the Fed said in the last 2 or 3 days that we are in a recession and that you're coming in—looking at the same data—and you're not convinced that we are.

Mr. VOLCKER. I wouldn't exaggerate that difference. Maybe I'm too cautious a man, Senator. It would not surprise me at all if we are. But I think the one thing that one cannot judge—and this does depend on the energy situation, I think, on how much of the impact the economy has had from that particular situation—is whether this could conceivably prove to be quite temporary, if the gas lines are going away. That's the one question I have in my mind.

Senator RIEGLE. I hope that will be the case. Coming from Michigan which is the leading automotive State, although by no means the only one—there are other States with major automotive manufacturing concentrations—I sense a very pronounced smell of recession.

Mr. VOLCKER. There is no question in that industry.

Senator RIEGLE. Let me go to the concern that I've heard some people express about your nomination. As a person with very heavy banking experience and a close knowledge of the relationship both of domestic banking and international banking and international finance, that your orientation would be very heavily in that direction and less toward domestic economic policy as it would relate to recession and unemployment. How do you respond to that concern, which a number of people raise?

Mr. VOLCKER. Again, my basic approach, Senator, is to say that I don't think these problems are really distinguishable over a period of time. If we try to distinguish them, we get in trouble, because we've got, to have the economy operating effectively domestically—that's the ultimate object, in a sense—and it's not going to do that if we let inflation get out of control or, indeed, if we let the international situation get out of control. So I see them as part of one piece.

I also note we have more than one instrument for attacking these problems. That is true, in the overall sense, of the mix of monetary and fiscal policy. I think it's also true in a more particular sense. We ran into a situation earlier this year certainly where, with the unemployment rate still not much below 6 percent—high, too high, in any kind of historical context; who wants 6-percent unemployment—we had at the same time evidence of the beginnings and the actuality of shortages in some industries, of insufficient capacity, rising price pressures. All of which suggested that the answer to that remaining unemployment problem wasn't going to be found in overall demand measures. Anyone living in New York City as I do, or in the Detroit area—in any of our large urban areas—can't help but be conscious of the kind of unemployment problem we have and the misery and degradation in those areas.

And you see enormous needs. You see unemployed. Now we've got to have some way of getting at that problem, but the answer may not be in an overall macroeconomic policy.

Senator RIEGLE. Here's the thing that worries me. You and I have had a chance to meet and talk with some of the central bankers from other Western economies. The other economies are very sophisticated, I think, in terms of managing their economic affairs, and in pushing down their unemployment rates. In the United States, we're caught in a situation where the dollar is still the lead currency. I'm not sure it makes sense for us to continue to remain in a posture where we allow that to happen. Because it seems to me we accept a bigger dose of the aggregate of Western economies' problems than perhaps we ought to be taking.

But when you talk about a 6 percent average unemployment rate in the country—of course it's very uneven. In some places it's 2 percent; in other places it's 20 percent. And what I'm concerned about is that the monetary tool is such a blunt instrument that if we're going to slow the economy down to fight inflation with tight money and high interest rates, it has an altogether different kind of effect in a depressed area than it does some place that's relatively healthy. And what I'm concerned about is insuring that the Fed show the kind of sensitivity in its policies that would really take into account the unevenness of the unemployment problem. It's not just when you've got a 6 percent global unemployment rate, but if we're on our way up to 7 or 9 or somewhere in that range, which a lot of folks are predicting, I would not want to see monetary policy managed with an eye on the international banking community while we go through havoc in a number of industrial areas in the United States.

How do we prevent that?

Mr. VOLCKER. I suppose I think that analytically we have two different problems. Our job is, obviously, not to be insensitive to unemployment in general, nationally, or to the rate of economic growth. That's the name of the game in the long run. Where I may have a difference—I don't know as I do—is that I don't think that problem can be solved without the kind of stability of which I speak, whether you're talking about the domestic inflation or international markets. That's got to be part of the framework of dealing with that general national problem.

The point I was trying to make earlier is that I think there are limits to what can be done with demand management, so to speak, in dealing with the kind of unemployment problem you have in Detroit or we have in New York. I think it takes, basically, a different kind of policy at that point, which is not within the competence of the Federal Reserve. That doesn't say it's not terribly important; in fact, it's crucially important, I think, to our health as a society that we devise some way of getting at these problems.

One of the things that strikes me when I go around the world is that some other countries—for whatever reasons, cultural or otherwise—have at least succeeded in managing their economies without such extreme pockets of poverty and unemployment.

Senator RIEGLE. If I may just interrupt you, that's exactly right, and I've thought about that recently as I've looked at other countries. We are taking in a large number of boat people and the Japanese agreed to take 500. They have in fact taken only 100. Defense spending is another case in point. We carry far and away the lion's share of the burden in per capita defense spending. These are some of the things that account for why we're in this situation. What I'm concerned about, and what I'd like to hear you give us some indication of is, when the unemployment rate in the United States starts rising, at what point does it trigger a sense of alarm in yourself? As a member of the Federal Reserve, when do you say it's time for you to reverse monetary policy to stimulate the economy of the United States and get people back to work? What level would ring that bell in you?

Mr. VOLCKER. I honestly don't think I can answer that question in those terms, because monetary policy is not the only instrument of policy.

Senator RIEGLE. Understood.

Mr. VOLCKER. It depends upon a total approach. We have to remain in communication with other economic policymakers.

Senator RIEGLE. But I'm sure you would agree that even if we use the other tools, fiscal policy, or what have you, that if monetary policy remains restrictive and interest rates are going to be up in the double digits, it would be very hard to give the economy a lift.

Mr. VOLCKER. In a discussion of this sort, we always get into some confusion on how to measure monetary policy. Looking at it over a period of time, I think its fair for the purposes of my discussion now to think of monetary policy in terms of what's happening to the money supply; that doesn't tell you what happens to the level of interest rates directly. You would expect, in a slack economy, all other things being equal, and the money supply equally restrained—if that's the right word for what's been happening—that interest rates would be lower than in a situation where the economy is moving forward very rapidly, pressing against the limited capacity.

Having said that, I am going to come back to the basic point, that the most important interest rates in this context are probably longer term interest rates. Those interest rates are very heavily dependent upon what expectations are concerning the future rate of inflation. And, again, we sometimes have this phenomenon, as I think I suggested earlier, that a policy which is interpreted as a noninflationary policy is good for long-term interest rates—by good, I mean declining long-term interest rates.

So you can escape, I think, from the basic relationship that restrictive policies mean high interest rates. But we're not going to deal with that interest rate problem that you're concerned with—indeed, I'm concerned with over a period of time, because it is not good, all things equal, for investment—until you recognize it as a symptom of inflation. And we can't deal with the symptom without dealing with the cause.

Senator RIEGLE. My time is up. I would just hope that we would not get fixed on a course where the belief was that the economy had to go through the wringer and that monetary policy would remain restrictive, and we would endure an overly severe and overly long recession partly because of the pressure of our friends abroad. I hope that at some point we would fight for ourselves.

Mr. VOLCKER. There's no question about that. I don't want to suggest that any of these problems are easy or that I know the answer to all the questions. But in terms of dealing with the international side of that equation and not having us the residual country in which all problems end up on the doorstep of—if my syntax is correct—I've had a certain experience in trying to deal with the problem with my colleagues abroad for a number of years, and I think I'm sensitive to it and conscious of it.

Senator RIEGLE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kassebaum?

Senator KASSEBAUM. Mr. Volcker, I would just like to say it certainly is a pleasure to have you here and have someone whose name—just by the reputation of your name—has restored confidence in the money markets last week when the announcement was made of your appointment. You mentioned economic stability. Of course, that's what we've all been talking about.

I'd like to know what you consider, say, the top three priorities in restoring economic stability?

Mr. VOLCKER. The top single priority seems to me to be to deal with this problem of inflation that we've inherited and that has indeed been somewhat exacerbated recently. And that is very much tied in, both as cause and effect, with the energy situation which, of course, is an important problem in and of itself.

Now, in mentioning those as priorities, in some ultimate sense the priority is the growth and prosperity of this economy. I simply put those others as a matter of priority because I think they are essential avenues, essential parts of the solution to achieving the growth, prosperity, and productivity that we want. We haven't done so badly on growth, actually, in the aggregate sense in recent years. We sure have not done well on productivity. We have not done particularly well on investment which, of course, is related to the productivity situation.

We are going to have to restore the basic preconditions for that kind of growth and productivity that we want. In a sense, when I put the emphasis on stability and on inflation and on energy, they're kind of approximate goals to that ultimate goal in employment and growth.

Senator KASSEBAUM. You said earlier, I believe, that you saw no evidence of any shortage of money in the market right now. Does this mean that you do feel that interest rates should be higher?

Mr. VOLCKER. I don't think I want to begin my career as Chairman by projecting just where interest rates might be or where they should be. I guess that's something we have to continue to look at as time passes, and it depends on too many crosscurrents in the economy for it to be sensible for me to try to make a prediction at this point.

Senator KASSEBAUM. Thank you.

The CHAIRMAN. Senator Sarbanes?

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Volcker, you're extraordinarily qualified for this position. I think it's very important that there not be a hiatus or an interruption in the chairmanship of the Federal Reserve in terms of the office being filled. Therefore, I think your careful and prompt confirmation an important item. I would not regard it as desirable. In fact, I would see the potential of some serious difficulty if Chairman Miller were to leave the Fed and go over to the Treasury and the office of the Chairman would remain vacant even for a fairly short period of time, given the volatility of how the markets move.

I want to ask you three procedural or process questions before I get to matters of substance. First, how much of a role as a public spokesman on economic policies generally do you think the Chairman of the Federal Reserve should assume?

Mr. VOLCKER. I suppose your emphasis there is on "generally." I think the Chairman of the Federal Reserve inevitably is thrust into the role of being a public spokesman for the Federal Reserve. I think Federal Reserve policy is important. I think it cannot be conducted in a total vacuum, so inevitably one is drawn into commenting to some degree on related policies. But I do not see it as my function to defend or develop detailed economic programs in other areas.

Senator SARBANES. How open do you think the Federal Reserve's decisionmaking process should be?

Mr. VOLCKER. I think it's inevitably quite open in the context of our society and at the insistence of this committee. In fact, I don't see how it can be more open than it has been. I think when we deliberate on specific monetary policy actions and explore the alternatives for a particular period ahead, that must be a closed process. But that is entirely consistent with coming here and elsewhere and defending the nature of the actions that we have taken and exploring in general terms alternatives for the future. I make this distinction between the ultimate decisionmaking in very concrete terms, month-to-month and week-to-week, which I think has to be a deliberation that proceeds privately.

Senator SARBANES. Well, now accepting for the moment the parameter that the Fed Chairman will not be commenting about economic policy all over the landscape but would focus more on the Fed's particular area and that certain specific decisions have to be taken in the manner you've just described, how much of a responsibility do you feel for enunciating and explaining the decision in a way that the press and the public can understand it as opposed to sort of a Delphic utterance. [Laughter.]

It being handed out by the Fed, and——

Mr. VOLCKER. I understand the problem, Senator. I wish I could promise that I would be so articulate in this area that I would always be crystal clear to everybody. I would like to be. I'm not sure that it's safe for me to make a promise that may be beyond my capacity.

Senator SARBANES. You might be able to make a real contribution. You bring enormous skills and really a lifetime career essen-

50-058 O - 79 - 4

tially in the Federal Reserve system, and one of our problems may be that these policies are not being adequately and sufficiently explained. I'm not talking about someone sitting there when you feel you have to go into a closed session because of the sensitivity of the specific decision, but once it's made—and really opening yourself up to explaining it, responding to the press in terms of its inquiry, because we can bring you here at any time. The nature of the response we get depends on how forthcoming you are before the committee. And I'm just trying to get some feel for the possibility you see in that area.

Mr. VOLCKER. Let me make one comment on that in general terms; it may or may not go in the direction you're speaking of, but I think it does go in that direction. I would not call it a byproduct, but a major element in the approach that has been taken in recent years—and my understanding is with the sympathy, even at the urging of this committee—is to place more emphasis on monetary targets, on the money numbers. This is, among other things, a vehicle for explaining to the public what our essential policy is, the nature of that policy, the way we think it works. Indeed, it's helpful in explaining policy to ourselves sometimes and putting a discipline on these short run actions.

And I would like to think that this has helped and will, indeed, continue to help to provide the kind of vehicle for explaining our objectives, explaining particular actions in a longer run context in a way that is understandable to a much broader public than some of the arcane and elusive descriptors that have been used in the past.

There are always limitations on that process, and one of the serious limitations we have at the moment is that recently the meaning of those money supply figures is not as crystal clear as one would like to see it, which gets us into complications about what modifications in analysis have to be made, which in turn spins out into additional complications, and so on.

But I think that this committee has pioneered in making these conversations more intelligible. I hope we can build upon that, and I hope we can maintain reasonable confidence in the money supply figures.

Senator SARBANES. The third procedural question I wanted to touch on was an issue that has already been raised with you, and that is this question of how one reconciles the independent role of the Federal Reserve with the necessity to coordinate overall economic policies so you don't have different organs of the Government working at cross purposes. Of course, you respond with an emphasis on close communication consultation. You've watched that problem over the years. When and under what arrangements do you think it would be best addressed?

Mr. VOLCKER. As you say, I have watched this process over a number of years, and the precise way it works is influenced by personalities on both sides of the street. But I do believe, among other things, that as a kind of basic framework, there should be some regular procedures for meeting together with the chief economic officers, in particular the Secretary of the Treasury. There should be some kind of regular pattern, in addition to all the consultation that must go on in an ad hoc way. That has been the experience so far, and it's worked pretty effectively since the late 1950's. We've had 20 years or more of this kind of procedure. It has not prevented all arguments. It hasn't prevented some disagreements. They are inherent in the situation. But, by and large, the situation has been pretty satisfactory.

Senator SARBANES. Do you see the regular procedure that you feel needs to exist and be carried out essentially involving the Chairman of the Fed and the Secretary of the Treasury? Or do you see a quadriad?

Mr. VOLCKER. You know, whether it's the quadriad or some other particular group is certainly in large measure shaped by how the President, himself, would want to do it. I think continuing communication with the Secretary of the Treasury is a part of the tradition, so to speak, and, indeed, given his role in the administration, it is a natural focus; but the process is not limited to that focus.

Senator SARBANES. I see my time is about to expire. I will withhold—are we going around again?

The CHAIRMAN. Yes. Senator Lugar?

Senator LUGAR. Mr. Chairman, Mr. Volcker, it seems to me one of the ironies of this hearing and the speed as well as the reception that your nomination has received in the press and the financial community is that the policies of the administration give such a sense of unease to people that your nomination in itself is perceived as being a strong bulwark, and therefore a responsible activity of the committee would be to confirm you rapidly and try to bring about a degree of confidence through that situation alone.

It's an ironic one and puts you in a difficult position, because it's anticipated that a good number of things are going to occur through your leadership. And indeed they may.

But if you could go back historically for a moment, what would you have to say about how things worked out in the two devaluations of the dollar in 1969 and 1973 in which you were involved. Were your expectations in terms of monetary stability worldwide were fulfilled, or what went wrong in the process?

Mr. VOLCKER. My hopes, at least, were not all fulfilled. I think we faced a difficult situation then from the standpoint of the United States and from the standpoint of the world. A change in exchange rates was necessary; it had become necessary, unfortunately. The risk in making that change—in dislodging some well accepted conventions, if you will—was of contributing to a kind of atmosphere of uncertainty and instability.

Now I don't by any means blame everything that happened on those devaluations. The inflationary situation has been much more central. But, to some degree, that change probably contributed to the sense of instability. It was maybe inevitable in the situation. I devoted a good deal of effort, as you may recall, during and after those devaluations, to trying to negotiate a stable international monetary system. I think it made me extremely uneasy at the time when as a country we became a little overly enamored of the view that we could forget about exchange rates and take the attitude that, "We'll just let these floating rates go where they will, and that'll take care of all the problems." If the dollar went down, it was no great concern of ours.

I think that kind of attitude contributed to the problem. I think it was always an illusion. What we have learned—but learned from harder experience than I would have wanted to go through, ideally—is that we couldn't ignore these things. I think that's the lesson of what's happened in recent years. In a sense, that lesson culminated in the program that we had in November, which I do think was kind of a psychological watershed—I hope it was—in the way we deal with problems of economic policy.

We have to recognize not only the inflation problem, but also that we have to shape an effective domestic policy in a context of what's going on in the world. The United States has shrunk in relative terms as part of the world. The amount of international transactions has increased enormously, whether we look at trade—which has more than doubled from 10 or 15 years ago in relation to the economy—or the amount of investment transactions that go on. The ease of communications internationally has produced a different kind of world where we can't ignore exchange rates, not because our primary emphasis is on what's good for the world—although that's not unimportant—but because the question is, How we can run our internal economy?

I'm saying we can't run our internal economy without some awareness of how we fit into the world; we can't run it effectively, and we can't reach these objectives in employment, for instance, if we ignore that.

Senator LUGAR. You have just characterized the November activities as a watershed of sorts. I'd like you to follow on it in this way: Are you stating essentially that that activity had to be taken by the Fed at that point in conjunction with the Treasury Department, because the worldwide condition—a potential run on the dollar, for example—was so great that domestic considerations really had to be subordinated, or in fact there was no hope for reconciliation of domestic and international policies.

Mr. VOLCKER. No, I would state it quite differently, Senator. I think it was a watershed in the sense that there was a recognition that policy could not be shaped without taking account of international considerations. I do not see that as inconsistent with domestic goals.

I would state it the other way around. We're not going to have an effective, total economic policy, including the domestic objectives, unless we're willing to face the complications that the international situation creates. Now facing that doesn't make it any easier. It's a complication of the real world. What I'm saying is we can't ignore it, because our domestic goals will be undercut. It's not an either/or situation.

Senator LUGAR. In the current situation, this may just be a topic or pause that we're going through. But the thought has been that the action by the Fed in recent days has been caused substantially more by an attempt to assure people abroad than by specific domestic considerations.

Is that your characterization?

Mr. VOLCKER. Again, I hope this is a situation where there's no sharp dichotomy between the domestic and the international considerations. The international consideration, the concern that was expressed at the dollar, was certainly something that properly needed to be taken into account recently, in my judgment.

That happened to coincide with a period when the money supply was increasing quite rapidly. If one just looks at the so-called domestic criteria, there remains that effort to work toward domestic monetary discipline, which, of course, is completely consistent over a period of time with what is necessary to keep the dollar stable internationally. So even in this recent action I don't see a sharp dichotomy.

Senator LUGAR. Mr. Volcker, attempts are underway in this Congress to repeal or modify the Credit Control Act. What is your judgment about the wisdom of repealing the Credit Control Act?

Mr. VOLCKER. Very frankly, I've perhaps not been as acutely aware of the fact that that statute still existed as I should have been. I think the fact that I have not been so acutely aware of it reflects my feeling that I do not see the circumstances arising in which the law would be particularly useful.

Senator LUGAR. So it would be fair enough—as one of the cosponsors of that act, I would raise it from that viewpoint—that you would tend to favor our attempt to move it off the statute books?

Mr. VOLCKER. I don't see why I should object. I understand that the Board of Governors has taken the position that they also don't see any strong reason to get rid of it, although they don't see any intention of using it.

Senator LUGAR. Would you favor paying interest to banks on reserves held in the Federal Reserve?

Mr. VOLCKER. We had some discussion of that earlier. My position, going back over some period of time, is that this could well be the most logical and straightforward way of squaring the circle that I see here—the need for maintaining reserve requirements at adequate levels, but at the same time not so penalizing the institutions upon which the reserve requirements are placed that they're put at a competitive disadvantage in the marketplace. This issue comes back and affects our ability to conduct monetary policy.

Now, the discussion in the House has taken a somewhat different tack. It's possible that we can work out the situation without the payment of interest on reserves. I'm open to exploring those avenues as well.

Senator LUGAR. Would you favor continuation of purely voluntary membership on the part of the banking institutions in the Federal Reserve Board?

Mr. VOLCKER. If you're going to have purely voluntary membership—and there are attractions to that, philosophically and otherwise—I think you then have to be willing to go pretty much all the way in relieving the costs of membership. It just doesn't make sense to me to rely upon voluntary membership to preserve the strength of the Federal Reserve, when at the same time you penalize the banks who voluntarily choose to be members.

Now, there's been a problem, quite clearly, in meeting those preconditions that it seems to me are necessary to make a fully voluntary system operate. There is also the problem that a system that looks adequate on a voluntary basis today, probably would have to be reexamined over a period of time to make sure that new institutions didn't spring up too freely and again push the voluntary sector too far.

I'm not philosophically opposed to voluntarism. After watching this debate proceed now over a period of 2 or 3 years, I guess I'm a little skeptical that the preconditions of voluntarism consistent with a strong Federal Reserve can be met.

Obviously, the mandatory approach gives another avenue.

Senator LUGAR. Thank you very much.

The CHAIRMAN. Mr. Volcker, commercial banking is notorious in its discrimination against minorities—blacks, women, and even white male Jews and Catholics. We have hearing records that are just replete with the evidence.

Mr. VOLCKER. You're speaking of their employment practices?

The CHAIRMAN. That's right, employment and promotion, particularly promotion with respect to women. Women are hired, but they're rarely promoted.

What did you do in 4 years as president of the New York Federal Reserve Bank to overcome this discrimination?

Mr. VOLCKER. I can speak directly to the situation at the Federal Reserve Bank of New York. I would not at all categorize its practices as discriminatory when I arrived there. But we have had what I think is a pretty good record in both employing and advancing women and minorities.

We have a very sizable proportion of women both on our senior staff and on our officer staff. The proportion of minorities has increased substantially. And we have pushed just as hard as we can in that direction.

It's not easy. It becomes progressively more difficult as one gets at higher levels. In New York we run an institution that has a great many minorities on the total staff. Our problem, as with other organizations has been in finding the most qualified among them, and pushing them ahead into the senior and official positions.

The CHAIRMAN. As Chairman of the Federal Reserve, what would you expect to try to do with respect to the commercial banking industry generally?

Mr. VOLCKER. I suppose, No. 1, show a good example. We in the Federal Reserve——

The CHAIRMAN. Let me just interrupt. It's more than a good example, isn't it? The fact is that as you employ, as examiners and so forth, blacks and others who haven't been given a chance, it gives them a chance to get the training and the expertise, which is the principal reason, in my view, that they haven't been hired.

Mr. VOLCKER. That's right.

The CHAIRMAN. This is something that I think the bank regulatory agencies have been very remiss in affirmatively pursuing.

Mr. VOLCKER. I suppose we have something of a conflict of interest when one looks at that. As we find good people, which we do, we love to keep them. But historically the Federal Reserve—particularly the Federal Reserve banks and particularly in the areas of economic research and bank examination, as you point out—have been a kind of training ground for competent staff for banks generally.

So, I think we can do something in that area, not just by example, as you say, but as a part of our normal existence, as we train these people, as banks become aware of them through their normal contacts, they are going to be hiring them away from us.

In terms of the actual enforcement of the statutes on employment practices of the banks, to the best of my knowledge, those areas don't come under the Federal Reserve, but rather the Treasury and other agencies.

The CHAIRMAN. It's my understanding that you enforce the statutes with respect to State member banks, which are considerable, a thousand banks. That would really set an effective example.

Mr. VOLCKER. I do think, although I would only have to speak here from general impression, that your initial statement about the banks would have been valid some years ago. I think in my particular area, which is all I can talk about, the situation is considerably better.

The CHAIRMAN. We'll be happy to send you some of the documentation we have had before us, because it's still shocking, according to the witnesses who have testified within the last few months.

Now, you told Senator Armstrong that you will serve out your term. That was a little ambiguous. You have two terms. You have one term that's 4 years and one term that's what, 12½ years?

Mr. VOLCKER. Right.

The CHAIRMAN. I hope you will serve until 1992, God willing. Could you clear that up?

Mr. VOLCKER. I am being appointed, Senate willing, as Chairman. I have no other position or intention in mind at present. I answer in the spirit of being appointed as Chairman.

The CHAIRMAN. What can we do to overcome this very serious problem we have of turnover on the Board? We have an average turnover of about 2½ years now, as you know. They're supposed to be appointed for 14 years, and with this turnover we have a loss of independence, a loss of competence, expertise, experience and so forth—all the things that the people who established the Federal Reserve were counting on.

Mr. VOLCKER. We have a loss of experience, certainly, and I do think it is disconcerting.

The CHAIRMAN. A loss of independence, inasmuch as the person is appointed by the President and I think you tend to have more of a feeling of obligation.

Mr. VOLCKER. Recent Presidents have appointed, if not all the Federal Reserve Board, virtually all the Federal Reserve Board, and I think it's fair to say that that was not the intention.

The CHAIRMAN. And President Carter will make his fifth appointment to the seven-man Board in January.

[The following table was ordered inserted in the record at this point:]

CHANGES IN FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS MEMBERSHIP BY PRESIDENT

President and dates of term	Number of changes in board	Number of positions filled at end of term
Wilson, 1913 to 1921	4	5/5
Harding, 1921 to 1923	5	3/6
Coolidge, 1923 to 1929	1	1/6

CHANGES IN FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS MEMBERSHIP BY PRESIDENT—Continued

President and dates of term	Number of changes in board	Number of positions filled at end of term
Hoover, 1929 to 1933	2	2/6
Roosevelt, 1933 to 1945	10	7/7
Truman, 1945 to 1953	9	5/7
Eisenhower, 1953 to 1961	3	2/7
Kennedy, 1961 to 1963	2	2/7
Johnson, 1963 to 1969	3	3/7
Nixon, 1969 to 1974	5	5/7
Ford, 1974 to 1977	5	5/7
Carter, 1977 to present	5	4/7

Mr. VOLCKER. The turnover has been too rapid, I fully agree. But I don't think that comments upon the competence of the individuals. I think we have been extremely fortunate in being able to have very competent people on the Federal Reserve Board. But I agree with you that generally the turnover shouldn't be nearly so rapid.

I don't know what all the answers are. I do know you're aware that the salary question inevitably enters into the judgment of some of the people that have served or, perhaps more importantly, some of the people that have not wanted to serve.

Beyond that rather concrete factor, I think it's difficult to comment further. I rather sense that the sheer regulatory burden, much of which is initiated by the Federal Reserve pursuant to acts of Congress, may be a factor in terms of being forced to deal with so many specific decisions that are rather unlike what one conceives of as the general function of the Federal Reserve Board. But I wouldn't want to overemphasize that.

The CHAIRMAN. I hope we can work with you in easing that regulatory burden. As you know, I've been pushing hard to get a single bank regulatory agency. It would not be the Fed and it would relieve you of that burden. I'm delighted to hear that there is at least one reason why you might——

Mr. VOLCKER. I want to make a distinction.

The CHAIRMAN. I was afraid you would. [Laughter.]

Mr. VOLCKER. A very proper distinction, Mr. Chairman, between the bank supervisory role—I am on the record a number of times as saying I think this role is important to the Federal Reserve and it has never, by the Federal Reserve Board, generally anyway, been thought to be a burden—and extensions of the regulatory power into, shall I say, some nontraditional areas in recent years.

But the Congress has seen fit to charge the Federal Reserve with these responsibilities. I have taken it, in part, as a compliment that we've been considered an agency that could develop and administer these fairly and without prejudice. To the extent Congress decisions have been based upon that conception, I have to agree with those decisions. It's partly a matter of internal organization, perhaps, and maybe we can have some ideas on that.

The CHAIRMAN. A proposal that would certainly affect the independence of the Fed is one in the House that was advanced from the subcommittee, as I understand it, and it would provide that the chairmanship of the Fed be coterminous with that of the President, start a year after he is elected, and let each President, in effect, appoint his own Chairman of the Board of the Fed.

How do you feel about that?

Mr. VOLCKER. I am generally aware that that issue has arisen. And of course, it's an old issue. It goes back to the early 1960s. And through the years I have had a certain sympathy for the concept.

I must confess, upon looking at it face to face and being forced to rethink the concept a little bit, I can see certain problems that would arise with very short terms created when a chairman became disabled or left for whatever reasons. Perhaps it's not as easy a question as I thought it was in the past.

While I have had some sympathy for the proposal—and I would say that—I think there are also some problems. Maybe I can think about it a little more.

The CHAIRMAN. According to a report of the New York Times on Friday, you said at a press conference that you were going to take a tough stand on inflation and that you wanted to reduce inflation quickly. Of course, we'd all like to reduce inflation quickly.

Mr. VOLCKER. Right.

The CHAIRMAN. But what specific anti-inflation actions do you have in mind?

Mr. VOLCKER. I don't doubt that I said "quickly" at some point, but I think I probably said—I certainly did not suggest that this was something that I had any magic solution to. I did not say that it was an easy problem or that anyone should have any anticipation that there is some way the inflation problem is going to be gone next year. That's obviously not the case.

The present situation we have is not with inflation on the downswing; it's on the upswing.

What I meant to convey was that this was a matter of real priority, and I think we should proceed as quickly and effectively as we can. It's been getting worse, not getting better.

Now the big setback this year was certainly from the OPEC oil situation. But the sooner we can get on top of this situation, the sooner we can turn around the rising trend and make it a declining trend, I think the easier we will find it to restore an expectation that the problem can be dealt with.

What we're finding now is the reverse, in a sense a perverse psychology; the American people have, I suspect, become convinced as never before that inflation is here to stay and that it may rise. That affects activity; it affects the way they invest; it affects what they buy; it affects what they do. It makes our job more difficult.

The first priority is to demonstrate that that's not the case, that we don't face a situation where inflation inevitably has to rise. And I hope—and perhaps at this point I should put it no more strongly than that—that we can get that psychology turned around through persistence and disciplined policies, and as we do we can find it possible to move more rapidly to restore stability.

The CHAIRMAN. But to reduce inflation quickly, you feel that you would retract that?

Mr. VOLCKER. I retract an implication. I don't think this is what I said or implied the other day, so I don't think I'm retracting anything.

50-058 O - 79 - 5

I don't want to give any impression that we have a solution that's going to make the inflation rate from here on out begin declining very rapidly. We're not at that stage yet. The first thing we have to do——

The CHAIRMAN. My time is up. I just wanted to know whether or not you felt we could begin to turn it around.

Mr. VOLCKER. I would hope we can begin to get the psychology turned around.

The CHAIRMAN. So that it's not rising as rapidly as it did?

Mr. VOLCKER. I certainly hope it would stop rising as rapidly; that's an attainable goal. And I hope leveling it off is a quickly obtainable goal. And I hope that we could begin to see some declines in the foreseeable future. I think it's terribly important we do. But we are at a very high level, so there's nothing we're going to do in a matter of months to get rid of inflation.

The CHAIRMAN. Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

Mr. Volcker, the chairman asked you a question, and I will pursue it, as far as this bill passed by the House subcommittee last week on making the Chairman of the Federal Reserve Board's term take place 1 year after a President has been elected. This certainly was not aimed at you, because the bill was in progress a long time before you knew you were going to come here.

It is not prospective, but it would affect your term and you would be through, at least on your initial appointment, by January 1982, only having served 2½ years. I only bring it up, not to pursue it further right now, but I hope that you would think about that, not in terms of your own term but the overall situation of what that would do to the Federal Reserve, would it politicize it; and the thing you mentioned to the chairman about short terms.

Mr. VOLCKER. The problem I see, not thinking of my own situation, is that you could possibly face a situation where an incoming Chairman had a much shorter term even than I would have under these circumstances. I don't know how you'd deal with that particular aspect.

If governors served a longer term, and we didn't have the situation that we have had in recent administrations where the President was appointing the whole Board or close to the whole Board, I would not be completely negative about the idea that after a reasonable lapse of time a President ought to have a chance to look at the situation and not have to be at the whim of the calendar as to when a Chairman happened to be appointed to office.

There's kind of a dilemma here, as I see it.

Senator GARN. Not for purposes of this hearing, but I would appreciate it if you had more thoughts on that, that you could bring them before the Senate. Because I understand the dilemma. I have real concerns about the type of situation described: very short-term; no continuity whatsoever. You get a Chairman in and he has very little opportunity to start to work, and the President has gone and started the cycle all over again.

An article in Business Week 2 weeks ago was entitled "The Politicization of the Research of the Fed." The thrust of the article is that the research efforts of the Fed's economists are being forced into a mode and shape that's politically determined by the staff and the Board of Governors. The article indicates that evidence of suppression is the strongest in the New York and the Philadelphia Reserve banks. Economists pointed to instances of censorship in research papers, resulting from sensitivity to official Board monetary policy.

What's your reaction to that?

Mr. VOLCKER. My reaction to the article was that I frankly didn't comprehend what they were talking about. If the burden of the article was that I review what goes into our quarterly review, indeed I do review important output of our research department. I review it to see whether it's sensible, to see whether it's of a high quality. I review the output of the research department of the Federal Reserve Bank of New York; if that's all that article was saying, I plead guilty.

It seems to me an appropriate role for the president to have an interest in what the economists are producing and to review their conclusions. That seems to me to be all that article was saying, and if that's what it's saying, I do it.

Senator GARN. They cited one specific——

Mr. VOLCKER. The specific examples that they cited were an article on New York City, and an article on the money supply and how it should be computed. As to the former, anybody that's interested can read the article and see that it does not agree with what the Federal Reserve Board staff had published a few months earlier. It was in the form of a comment, in fact, on those proposals, and came out with a somewhat different position.

So that's one answer to the accusation that the Federal Reserve Board staff was totally dominant. In fact, I agreed with the general thrust of the article that was printed.

As to New York City, the only specific comment I would make is that it is true that I have tried to build up our urban research area. I think that's appropriate in terms of the problems that we had not just in New York City but elsewhere.

The only specific criticism I ever recall making on articles in our quarterly review on New York City is that perhaps they were too rosy, rather than the reverse, and might give a false sense of calmness, rather than pointing out the degree to which the problem still existed.

Senator GARN. Chairman Proxmire and I, having been deeply involved in New York City for 5 years, would share that view, that their optimism has been beyond the expectations that have taken place.

Mr. VOLCKER. I have not been accused, other than in that article, of being unduly rosy about what New York was doing.

Senator GARN. Thank you, Mr. Chairman. I have no further questions.

The CHAIRMAN. Senator Stevenson?

Senator STEVENSON. Thank you, Mr. Chairman.

I sense, Mr. Volcker, that you recognize that inflation, employment, levels of economic activity in the United States, and the economic condition of the country are rooted in a world that is out of control. I hope so. I know it's out of control, but I hope you share that perception.

Mr. VOLCKER. It is disturbed, at the very least.

Senator STEVENSON. You perhaps are being more diplomatic than I.

The United States once gave that world economic leadership. It virtually created the postwar international monetary system. And then it undercut the Bretton Woods arrangements that were created by linking the dollar to gold.

Now, hundreds of billions of Eurocurrencies, supposedly dollars, are sloshing about the world in mysterious ways, seeking safety and high rates of return. In this unstable environment, the dollar's reserve role has become extremely expensive for the United States in these conditions. It's no longer regarded as a reliable unit of value. Nothing is in this world.

So levels of international trade and investment are depressed by uncertainty. Sterling may be coming back into fashion.

How should the international monetary system be reformed, reliance on the dollar be reduced, and the United States give this world some international leadership? And if the executive branch is unwilling or unable, what's the international role of the Fed, or could it be, under a strong Chairman?

Mr. VOLCKER. I'm sure you're not expecting me to outline a specific plan for monetary reform this morning, which I am not capable of doing. I tried that once a few years ago.

I do think that this kind of reform effort is, in a real sense, more difficult than it was in the Bretton Woods period you referred to, because then we stood astride the world like some kind of colossus—with the British, to be sure—and in a relatively small conclave, we were able to get together and establish a system the objectives of which were pretty widely agreed to, from a situation in which the United States had the strength and power to support and underwrite the system.

It wasn't so much the formalities of the system as the informalities—the Marshall plan, the subsequent aid program, the fact that the United States was willing to be discriminated against in trade and payments at that time, the fact that we were willing and could carry the defense burden—that made that possible.

Now the world has changed. Relatively, we're much smaller; relatively, we cannot carry with the same ease all the burdens that we carried at that time. Yet we're still the largest single unit. We still have to show some leadership, because nobody else is going to do so in the same way. And we've got to do it under more difficult circumstances, in a more collegial world, if you will. The underlying problem with which we are grappling is that when one looks at the picture of a world which is facing many more problems, as you suggested, in energy and elsewhere, it suggests the need for both political and economic innovation.

I think we see some of that political innovation coming into place—I'd like to think so—through the apparatus that's been developed at the top, for instance, in these economic summits, which provide a kind of focus for collaboration not just at the summit itself, but through all that implies for relationships in between summit meetings and attitudes between summit meetings.

And, on the economic side, there are some implications for the role of the dollar and substitutes therefor. This is a very difficult area, but we can't expect to run the world, in my opinion, with the same degree of reliance on the dollar that may have been suitable when the United States was in the position of having almost 50 percent of world GNP and, in terms of financial markets and financial arrangements, was perhaps even more dominant than that 50 percent of GNP would imply.

It's a different world now, so there has to be some way of sharing the responsibilities. That was not true in the same way earlier. This is always a difficult matter, economically and politically.

You asked about the international role of the Federal Reserve. We have a close interest, obviously. We have direct operations through our foreign currency desk in the international area, and we have contacts with foreign central banks. But, by long tradition, it is also true that the Treasury has the primary leadership in this area. By tradition, also, the Federal Reserve has worked very closely with the Treasury in this area, and I would hope that would continue.

Senator STEVENSON. Would a substantial across-the-board tax cut be appropriate in 1980 or 1981?

Mr. VOLCKER. I don't want to project that far ahead. I don't think it's appropriate right now. I think fiscal policy is obviously something you want to look at, particularly should the worst of the present prognostications be borne out. The administration has been on a course, as I understand it, toward fiscal restraint which I think is appropriate in dealing with this chronic budgetary deficit we have had.

I have strong sympathy for that approach. But, obviously, it has to be reviewed in the light of economic circumstances as they emerge. Let's see what happens in economic activity before pronouncing that judgment.

Senator STEVENSON. Are you familiar with the Fed's regulations for Edge Act corporations?

Mr. VOLCKER. In a general way.

Senator STEVENSON. Do you support them?

Mr. VOLCKER. I'm generally sympathetic with the direction in which they've moved.

Senator STEVENSON. Through these institutions, with their liberalized powers to finance trading——

Mr. VOLCKER. While I have not engaged in those discussions firsthand, my understanding has been that this approach was broadly consistent with the tenor of congressional wishes, as expressed during debate about the International Banking Act.

Senator STEVENSON. I wish you hadn't brought that up in the Chairman's presence, but you're absolutely right. [Laughter.]

And finally, Mr. Volcker, let me just remind you that until such time as the Chairman's reforms become law—and I suggest you not hold your breath—there is the Federal Financial Institutions Examination Council, recently created, which does afford the regulatory agencies, including the Federal Reserve Board, the opportunity to, as it were, coordinate their regulatory activities. I hope you'll take advantage of that opportunity.

Mr. VOLCKER. I hope so, too. Indeed, I think I've testified before this committee that I would hate to see the central bank lose all supervisory responsibilities, because I think it does help support our monetary policy responsibilities.

The point is sometimes made that the responsibilities conflict. I can imagine circumstances in which that is true. But I'd rather have the conflict out there in the open, to be reconciled within the Federal Reserve, rather than have two different agencies running off in different directions.

I think we can and will make some progress through this Examination Council, particularly in dealing with some of the irritations, big or little, that arise from inconsistencies, big or little, in attitudes of the different agencies.

Senator STEVENSON. Thank you.

The CHAIRMAN. Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Volcker, I wanted to pursue with you the whole issue of capital investment and capital requirements in the United States, stretching out, through the decade of the 1980's. And the reason I want to get into this is that every month it seems the story becomes more alarming in terms of what our capital requirements are. And also, at the same time, our capital losses, including the oil account and the trade account, is not as favorable as it might be.

But when I look at the period, say, in the early 1980's—let me just give you two or three specifics and then I can frame the question.

In the auto industry right now, assuming the auto industry in the United States stays in its current form, they're anticipating having to spend about $50 billion from 1980 to 1985 just in the normal course of meeting new product modifications and requirements. The Government regulation burden on top of that is estimated to add another $30 billion. So there's an $80 billion price tag that attaches just to that one private sector component.

Then you've got the whole question of what's going to be spent in terms of strategic weapons. The President is now talking about the M–X missile, a very expensive proposition, somewhere probably between $30 billion and $100 billion.

We've got housing needs, we've got all kinds of infrastructure problems. I gather that the water system in New York and probably most of the older American cities needs to be replaced. When I go around the cities in Michigan, I find that capital improvements and capital expenditures have been lagging for the last several years because the moneys had to go for operating budget activities. And so we're running down our physical plant in the country.

And that leaves aside both the whole question of our industrial base generally and how modern and up-to-date it is, say, versus the Europeans' or Japanese.

And now the synfuels are on the horizon, and the President's asking for, about $88 billion that he wants to recommend to be put in there.

I frankly say I don't know where we're going to get all the capital. I don't see it and I'm alarmed about it. It seems to me that we're caught in a situation where generating the kind of capital that will be needed and investing it, which we must do to stay competitive and to try to make some improvement in productivity, is almost beyond our capacity.

Now, two things I'm interested in. One is your own assessment of the capital requirements, looking out over the next several years, and how you see this extraordinary period of capital need.

And second, how do we think of how we try to accommodate the monetary policies of the United States to meet that internal need, when we're caught in this bind that Senator Stevenson and I have been raising with you of international finances?

Mr. VOLCKER. I have looked at this question in the past. I have not looked at it very recently, with synfuels and all the rest added to the picture. It's very hard to come to a concrete judgment about just where the best balance may lie. The need is certainly enormous, there's no question about that.

This country, in the past, has shown an enormous capacity to generate capital. I think our ability to do so has been undermined in recent years. It's been undermined by the persistence of big deficits. It's been undermined by a fairly high dropoff—I think you'd have to call it a failure—of private savings flows.

Let me come back to this uncertainty about the future and uncertainty about inflation. You can't expect to sustain high savings rates—which will be needed, I think—if people are so uncertain about the purchasing power of what they're saving.

The performance of financial markets in providing a return on our capital has been absolutely dismal for a decade. The stock market is lower than it was back in 1962. Bonds have not been a good buy for anybody in recent years, despite the current level of interest rates, in real terms. So in part the answer has to be tied up with this general problem of restoring stability.

Now beyond that, and if we can accomplish that, certainly interest rates would be lower and monetary policy could help set a favorable environment. But I would also point out—and it's particularly relevant to this box that you and Senator Stevenson have seen—that monetary policy isn't the only instrument here. I think there is a real question about whether our taxation practices have not been biased against savings and, more particularly, looking at the demand side of the equation, biased against investing and investment incentives.

I've long held that view. If I read correctly what's been going on in this city as well as elsewhere in the past year or so, I think there is more awareness of that now. The last tax bill, I think, was more favorably shaped on that dimension, and it also stimulated a lot of discussion about alternative ways of proceeding on a tax program that takes some of the weight off investment activity.

I think that's very healthy. Now, the other dimension, which you mentioned specifically in connection with the automobile industry, is this regulatory pattern. Obviously, our country has objectives other than investment and growth. The environment, safety, health, all the rest, are important objectives in and of themselves.

I certainly don't know all the answers in this area, but there must be some better way of weighing the tradeoffs and providing the degree of protection to social objectives that is essential without as much confusion and as much regulatory burden as we've succeeded in producing recently.

Now, if I knew the answer on how to accomplish that, whether were within my responsibilities or not, I would slip you the answer.

I know it is a very difficult problem, it's one we've got to deal with somehow.

Senator RIEGLE. This is the thing that concerns me. It also, I think, relates to the point that Senator Sarbanes was making earlier about once we know enough to be educated, to go ahead and do it.

It seems to me that the strategic margins of the United States have been dissipated. I'm talking about certain built-in advantages that we had with cheap energy and other competitive advantages with respect to the rest of the world. And this was before sinking a lot of capital into the Viet Nam war and other things, but it seems to me that where we stand in 1979 versus a decade or a decade and a half earlier is that we have pretty much exhausted our strategic margins.

I don't think we can afford very many big mistakes at this point, if any, which sort of puts synfuels up in a different position because we can't afford to do something that is going to cost $88 billion twice. If what we pick doesn't pan out I'm wondering if you and others aren't going to have to think outside of the forum that we've normally thought in in terms of how we'd handle the creation of capital and the availability of capital.

I agree with you that we're going to have to do things with tax policy, and we're developing some things, tax base, incomes policy legislation and some tax indexing legislation and something to deal with depreciation and so forth, but beyond that we're just tinkering. It may be useful tinkering, but it seems to me we're going to have to make a series of very sophisticated capital investment decisions as a nation that relate to our strategic future, our survivability, and our maintaining a position of strength in the world.

It's not just on the economic side. It comes over into defense matters as well. We've sort of gone speeding into the future with the old institutional arrangements and I'm not sure that we're set up today to, on a timely basis, to make very sophisticated capital judgments quickly, weigh these tradeoffs between what may be publicly desirable, versus what the private economy might decide to spend money on, and to work our way through a very tough period. I'm just wondering if that is the kind of view that you're developing as well, or for any kind of a situation which may involve having to think maybe even in terms of some new mechanisms, some new ways of tackling that kind of aggregate decisionmaking.

It seems to me we're losing ground today. I don't see us with an effective inflation program. We're way behind in the energy area, and I'm not sure that we can afford much more of that. It may well be that we have an institutional insufficiency here, that we've got to somehow rearrange ourselves and tackle these decisions differently.

Mr. VOLCKER. Let me say, I think the economy has had some hard knocks recently in terms of coping with inflation and the instability generally, but I have great faith in the ability of the market to sort out a good deal of this and I think that's got to remain our principal reliance, looking at industry broadly.

I don't have any doubt in my mind about that. There are also major strategic decisions of the kind you suggested, the prime example being energy. You talked about $140 billion programs that raise very directly the question that you suggest.

Senator RIEGLE. Can we afford that amount of capital?

Mr. VOLCKER. I think we can afford what we have to afford. But when you talk about making those decisions as part of a Government plan, it's very important that the right strategic decisions be made. What kind of mechanism is applied to that, what kind of decisionmaking apparatus is applied—I don't know what the administration might have in mind. But I agree that those are very important decisions.

And the structure of that program, the way those decisions are arrived at, is bound to be crucially important to the future of this country, given the strategic role that energy plays. Now, within that area, given my own predilections, I think a lot of weight has to be given to normal market incentives and judgments. That's one way to disburse the decisionmaking so that all the eggs don't go in one basket. But there is, I'm sure, a role for Government in this area. I don't have the answer to just how that is sorted out, but I agree with the general tenor of what you're saying.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Mr. Volcker, do you think the inflation we've been experiencing is attributable to an excess of aggregate demand in the economy?

Mr. VOLCKER. I think it's always a combination of things. If say, one looks back over the past 9 months, then, yes, I think that in some industries operating with a sense of shortage or potential shortage demand pressures are an element in the inflationary picture.

But inflation is a very complicated process, in my view. It doesn't just depend upon what the state of aggregate demand is today, but what it was some time ago, and the collective experience of business, labor, and everybody operating in the economy as to what they expect prices to be doing and how they try to protect themselves from what they expect and how they go about trying to increase their real income. Everybody likes to increase their real income, but when we haven't got any productivity growth there's no way we do that collectively.

But part of the inflationary process, I think, is that it leads to a very crude way of reconciling all those different demands so that people don't get what they really are aiming to get; things come out differently at the end of the inflationary cycle.

Senator SARBANES. Every time we try to take the price indicators apart, we tend to come back finding inflation tied to particular sectors, food, energy, right now housing costs, of course, which is tied to the interest rates. At the same time, we still have a relatively high level of unemployment and some unused productive capacity.

Yet all the talk is on the question of lowering aggregate demand and letting, in effect, the whole economy go soft instead of focusing on the particular sectors in terms of what might be done there. At least on the supply side analysis.

Mr. VOLCKER. The supply side analysis is very important. We need more emphasis there, and I've seen some movement in that direction. I do add, however, that decomposing the price indices all the time, and saying inflation is just due to this factor or that factor or the other factor, can be very misleading.

There's always some element in the index that's going up more rapidly than another element, and you can run around dealing with particular elements and find a different element springing up on you in the future. And sometimes it's not possible to deal with particular elements as effectively as one might like to.

So one has to look at the overall patterns as well as the particular elements. Take the energy situation, which is without question a major contributor to inflation. Even there, I'm sure the behavior of energy prices isn't entirely insulated from what's been happening with inflation in the world generally and in the United States in particular, and what's been happening with the dollar. What's been happening to interest rates also pops up in the price indices, but what's been happening to interest rates is clearly related to the overall inflationary movement, and you can't deal with interest rates in isolation either.

When you begin getting the momentum going in the other direction, that's one factor that will help you on the index, because as inflation begins going down, interest rates will go down. So hopefully, you can get the spiral to begin unravelling in the other direction.

Senator SARBANES. You're prepared to entertain the prospects of across-the-board, as I understand it from an earlier question, an across-the-board general tax cut if the economy goes softer than it now is, is that correct?

Mr. VOLCKER. I would certainly entertain the idea of a tax cut. It seems to me, based upon history, that it would be more desirable to place the emphasis there than on spending, if and when fiscal policy becomes desirable. I would also say, in connection with the conversation that I just had with Senator Riegle and indeed with some other factors that you've just been pointing out, that when you design a tax cut, you've got all kinds of opportunities for helping to deal with the investment problem and helping to deal with the cost problem.

Senator SARBANES. The point I want to make there——

Mr. VOLCKER. Speaking of payroll taxes in that particular area——

Senator SARBANES [continuing]. Is that if you're going soft with growing unemployment, the pressure is on not to have that kind of tax cut, but to have one that's going to move you back rather quickly. Now if that's the case and if you make an analysis over the long run that we have not been doing some of the things we should be doing to boost the productive side of the economy—which may include not only tax cuts but certain Government expenditure programs, in the energy area for one—wouldn't it be more prudent to move now before you move into a crisis situation, which will almost dictate a certain remedy to you in order to deal with that immediate problem?

Mr. VOLCKER. That's a tough one, but we do have a budgetary problem now. I would fully agree with you, with all the force that I can command, that if we come to the point of deciding that a tax cut is appropriate, we ought to design that tax cut not just for a short-term benefit, but to be as consistent as we can with what we need to do over the long run on productivity and investment and inflation.

Senator SARBANES. My point on that is that if you wait to do that until the short-term problem is quite serious or severe, then the answer is going to be a short-term answer.

Mr. VOLCKER. We're caught in a dilemma. I accept what you say about a risk. On the other hand, I don't want to be premature about it either. So——

Senator SARBANES. Let me go to another area.

Do you think that it should be an objective of our policy that we move the dollar less off the center stage internationally as the central currency and we seek to develop alternatives to that?

Mr. VOLCKER. I'm not sure I see how to do that or that I would welcome a kind of forced policy in that direction. As I see the structure of the international economy emerging, that will perhaps be a natural consequence, and we ought to be able to deal with that situation.

Let me go back in history. That was one of the considerations we had in mind in developing the SDR and activating the SDR in the first place. That's become rather quiescent in recent years for fairly obvious reasons: The supply of international liquidity has been going up too fast; we've had a lot of disturbance in international markets, and the occasion was not right for creating more SDR's. There is some discussion of so-called substitution accounts now, which would enhance somewhat the role of the SDR and perhaps, to some degree, diminish the burdens on the United States and on the U.S. dollar. There are a lot of problems that would have to be worked out if we were going to be able to negotiate that, but it's nothing we should resist.

Senator SARBANES. Are we paying now a heavy price or a heavy cost for having the dollar at center stage internationally?

Mr. VOLCKER. There are advantages and disadvantages, and I don't know where the net lies. I don't think it's a central issue of U.S. policy, as I see it, to maintain that. We're certainly not maintaining it in any kind of an artificial sense; then it would become a burden. But we cannot ignore the fact that the dollar at present is kind of central stage internationally, and it affects not only our economy but the economy of others.

Senator SARBANES. It's interesting to me that we get this sharp criticism on occasion internationally about the status of the dollar and its condition, but none of the countries that criticize are prepared to move their own to center stage and assume the obligation.

Mr. VOLCKER. I think that's right; that's quite clearly right, which is one of the limitations on what we can and should do. I think you can expect, judging from history—and I'm sure it will be true in the future— that almost anything we do will be criticized. In this area, all we can try to do is what we think is sensible, taking into account something of the needs of the world economy as well as our own. I'm not troubled by the feeling that in the end those things may be synonymous and what's good for the dollar at home is good for it abroad.

Senator SARBANES. I see my time is about to run out. I just wanted to close with this thought; I think you have an opportunity to make an enormous contribution as Chairman of the Federal

Reserve. You've worked within that system for a quarter of a century. I, for one, think that the term ought to be 4 years and the year after the President's elected. You have to have some connection or tie to the political forces in a democratic society. That doesn't mean you'll lose your independence, because that really rests on the integrity of the people who hold the office.

You put someone in there for 14 years, and if he had no integrity you wouldn't have any independence and someone could take it for a year and if he had integrity you would have independence. I think there's a need for the Fed to sort of explain itself to the country and not just to the banking community. The banking community has greeted your appointment with great favor. And it seems to me that base is obviously secure to you.

And there's a case to be made for exercising your leadership as the Chairman to explain the Fed and its policies to the country in such a way that the country comes to understand and perceive what its role is, and understand its concern with the broad economic problems in terms of maintaining a healthy economy. I think it means dealing both with inflation and unemployment if we want an economy where we're using our resources.

Mr. VOLCKER. There's no question about that.

I have great sympathy for what you are saying. I probably should not let your comment go by without saying that through the years I have not been entirely happy with my own or anybody else's ability to make some of these issues come home to the American people in a concrete way.

Money and the Federal Reserve are a great abstraction. I accept what you're saying, and I accept that it's quite a challenge.

Senator SARBANES. Thank you, Mr. Chairman.

The CHAIRMAN. I just have a few more questions, and I apologize for the lateness of the hour. You said in response to a question from Senator Riegle that you wanted to rely on faith in the market for encouraging investment and developing the kind of investment we need. Does that mean that you would agree that we ought to strike as quickly as we can the limitation on the rate of interest that can be paid on passbook savings for the small saver and the rate of interest that can be paid on demand accounts, either by a NOW account system or some other system?

Mr. VOLCKER. As you know, we were moving pretty rapidly to limit the effectiveness of those ceilings, and I think the whole tenor of events in this kind of inflationary situation certainly limits the usefulness of those kinds of devices.

The CHAIRMAN. I hope we can move rapidly. We've got a bill, the best Senator Cranston and myself could put together, that seems the most practical, but it's phased out over 10 years. It seems a long time.

Mr. VOLCKER. My hope would be, Senator, that if we can deal with this inflation—and I think we must within the kind of period envisioned by that bill or not long after anyway—and inflation begins going in the other direction, the market rate should come down, and you could then deal with the situation in the short run in the nicest way of all. The ceilings will become ineffective by effective rates in the market declining below the ceilings.

Now, as you know, the problem that we have at the moment is that we have an institutional structure which is essentially built on the concept of borrowing short and lending long. That was a great business for a good many years. It's not such a great business when interest rates are rising and when we reach the level of interest rates we have now. So we have a transitional problem which I don't think makes it possible—as that bill recognizes—to just say, "Well, tomorrow we're going to get rid of all the regulations."

The CHAIRMAN. One part of the anti-inflation program that many people feel has worked pretty well is the wage guideline. That has held wage increases in 1979 below what they were in 1978, in spite of the inflation. Of course, there's a terrible price to pay for the working person, but it worked. Do you feel that can continue to work, or do we need some kind of a tax inducement to strengthen that guideline—some kind of real wage insurance?

Mr. VOLCKER. Let me say I think it may have had some usefulness in the past year. I don't think it can continue to work by itself if all the other forces are going toward more inflation. So it can make a contribution under the appropriate circumstances, but it is threatened if other inflationary forces get out of control.

So far as the tax base approach is concerned, I've been somewhat intrigued by it. I think I once wrote the committee in that connection. But while somewhat intrigued, I don't feel that I've seen a really practical, workable scheme that allows me to say I'm ready to support that kind of a program.

The CHAIRMAN. Given the fact that in the short run, decontrol of oil prices is going to contribute to inflation, would you recommend that the President go ahead with decontrol of oil prices?

Mr. VOLCKER. Yes; I think we have to face up to this.

The CHAIRMAN. Do you think he should speed it up as some people have advised? Do his best to eliminate them entirely—the controls?

Mr. VOLCKER. I don't think I'm knowledgeable enough about that particular situation. I think we have to face the decontrol issue, despite our present problems. Let's face it and get it over with. I wouldn't comment on a complete and precise timetable.

The CHAIRMAN. Officials of the Federal Reserve seem to be confused on who's responsible for the manufacturing capacity utilization statistics. In fact, I had one top official of the Federal Reserve say that the Joint Economic Committee was responsible. The fact is that the Federal Reserve Board gathers the information. Yet, some people at the Fed have complained about how it's out of date. Arthur Burns did. Chairman Miller did. Will you as Chairman of the Federal Reserve do your best to bring it up to date?

The talk about 85 percent capacity utilization is ridiculous. We're at 95 or 97 percent. Will you try to do something about that?

Mr. VOLCKER. I'm familiar with the complaints, Mr. Chairman. That's the extent of my knowledge, and I will look into it.

The CHAIRMAN. Because it is your responsibility. I'm sure you're acquainted with the proposed takeover of Marine Midland by Hong Kong-Shanghai Bank. Senator Heinz and I have proposed a moratorium on foreign acquisitions until we can study them and get a report on them. American banks are an inviting target. What's your position on the takeover of U.S. banks by foreign banks?

Mr. VOLCKER. I delivered myself of a speech on that subject fairly recently which I'd be glad to submit for the record. It goes on for some pages on this subject.

The CHAIRMAN. Give me a few sentences summary.

Mr. VOLCKER. In general, the point I made was that, in considering the International Banking Act, Congress, or the Federal Reserve or anyone else didn't consciously consider this problem of large bank takeovers. I don't see any kind of emergency problem there. I do think it's worth looking at again to see whether the law might be modified in some respect for the long term future, but I see no immediate problems.

To the extent there is a problem, the most difficult aspect of it to me is the real and apparent inconsistency between the way we deal with banks internally and the way we deal with banks externally.

The CHAIRMAN. That's exactly right. That's the heart of it, and that's why we would like to have a little time to think it over.

Mr. VOLCKER. Right. It gets involved with McFadden Act questions; that is the most difficult aspect of the thing to me and, as it applies, the solution can't be found in the direction of dealing with foreign banks exclusively. You've got to look at them in that other context.

The CHAIRMAN. Senator Riegle, did you have more questions?

Senator RIEGLE. Are you finished?

The CHAIRMAN. Yes. I have a brief charge to the Chairman, which I will make at the end.

Senator RIEGLE. Thank you, Mr. Chairman.

It seems to me, Mr. Volcker, that you're really moving into a very different job from the one that you're leaving. It seems to me that being president of the New York Fed is a totally different ball game than becoming the Chairman of the Federal Reserve System—in fact, taking on a very substantial leadership position and responsibility on behalf of the United States—all of the United States—the banking community, the nonbanking community, and so forth. And I know from your background and from our conversations that you have a very solemn feeling about the weight of that kind of responsibility.

In today's New York Times—I'm sure you've had a chance to take a look at it—one of the articles in here in which you're mentioned is headlined: "Europeans Pin Hope on Volcker; See Fed Nominee as Key Economic Link." It's a very nice piece in terms of the friends that you have abroad, and I think it's fine that there is that kind of feeling in Europe toward you and toward your professional accomplishments, and I think that's going to be helpful at least in part in doing this job, but I think the other side of it relates to a lot of what's been said here today, and that is that I think you're in a position of having to be a different kind of a hardball player now than was true as president of the New York Fed, and I can see occasions arising where your friends abroad and mine and others here may not feel as friendly because of the nature of the change in position and the fact that they're going to have to deal with you in a different way. You've been, in a sense, in different kinds of policy positions in the past.

Mr. VOLCKER. May I be reassuring to you, Senator Riegle? There were periods in my career when these same foreign officials weren't all that happy with me.

Senator RIEGLE. I'm sure that's right. It seems to me that what has changed, though, is the fact that we're in very hard times. But I think it's obvious for anybody that takes a passing look at our major European—and Japanese as well—trading partners that they are doing the best they can to maximize their situation, whether it's by virtue of the fact that the dollar is still center stage as the international currency or through trade policies or through defense spending and differentials or whatever. Our trading partners have become—and our Western Allies have become—very sophisticated in moving their product problems offshore into our country to the extent that they have.

Mr. VOLCKER. There's no question of that. I think I know where our priorities lie, and we can't always expect them to fall nicely into accord with what the foreign countries find most comfortable at the moment. I've also had the conviction that in the long run our objectives have to be consistent; we're all living in one world.

I would like to think that it is helpful that I have an acquaintance and even a friendship with a good many foreign officials, but that does not mean that we're going to see the issues eye to eye.

Senator RIEGLE. I would agree with that. Let me tell you my immediate concern, and that is I have a serious sense of alarm that we may be headed into a recession that's worse than people are anticipating. I hope I'm wrong, but there are a lot of things that I think lend weight to that kind of a feeling that that may be what's happening. I don't know how our international friends will view the notion of the United States taking a higher level of unemployment for awhile and a more serious recession as a way to fight inflation. But my concern would be that if we allow ourselves to go in that direction very far, I'm not sure there are any net gains to be had. As you well know, every time the unemployment rate goes up 1 percent, the deficit enlarges by $18 billion. So we could be in this very quick ratchet the wrong way, if we're having to absorb a very large increase in unemployment that's taking place in this country.

My concern is this. I would hope that as Chairman of the Federal Reserve System, you would be fighting aggressively for policies that are first and foremost good for this country but obviously in the context of the fact that we're in a very complex and ever tightening set of relationships with the rest of the world, our allies first and then others. And obviously that part can't be ignored.

But it seems to me that we're going to need somebody who's very strong and effective on behalf of the American economy at this stage of the game. And if I can just add one other thought to it, we're into a very politicized environment at the moment. I think the President's Cabinet shuffle bears that out. The commentary by observers across the spectrum, I think, reflects that. And you've got at least half a dozen Republican candidates running for President a year ahead of time and moving into a situation where politics is apt to be more a consuming part of the puzzle than maybe has been true this far ahead of normal Presidential elections.

It seems to me that the leadership burden that passes to you right now is an extraordinary one. And to be strong enough to try to fashion, through the monetary side of things, Federal Reserve policies—strategies that are good for the country, good for the United States, good for the people of the United States, the public and private sector workers as well as managers, is really an enormous burden to take on right now.

I don't think that you fall short in terms of your determination to do that. In fact, I'm confident that you don't, but I would feel that I wasn't doing my job right if I didn't try to emphasize from the window through which I look the enormous responsibility you take on at this time because of these unique factors. And I certainly wish you the best with it.

Mr. VOLCKER. I fully agree with the basic point you are making. I am one man, but I will do my best.

The CHAIRMAN. Mr. Volcker, just let me sum up my position in a minute or so.

We've had some excellent Chairmen of the Federal Reserve Board. I don't think we've had anybody that's had quite the degree of relevant experience that you've had, and add to that experience the fact that you're obviously articulate, intelligent—you come in with a great deal to offer to the country as well as to the Board.

You have, however, with this experience and with your background, had one constituency most of your life. That's the banking constituency—the hard money, conservative, Wall Street, international constituency. And at the same time, you do have—it's obvious to all of us—a very clear, pragmatic streak. You're no ideologue. You're not a person who is just going to, as I, interpret what you've said here in your responses for the record—you're not going to be one who is just going to say: "By God, we're going to follow a monetary policy that's going to get down inflation, come hell or high water."

You realize in the first place that monetary policy is very limited, and the Federal Reserve Board's powers are limited.

Mr. VOLCKER. There are a lot of other policies involved in this problem that we're in.

The CHAIRMAN. And it will require persistence, of course, and the recognition that it's going to take time. At the same time, it's going to require a flexibility and a recognition that the price that some people have to pay, especially people who are not affluent and who suffer most from unemployment, can be very serious indeed.

I think we're very lucky to have you as the nominee. I think President Carter deserves a lot of credit for having selected you. In my judgment, your're the best man he could have picked for the job, and you'll do a great job.

Thank you very much.

Mr. VOLCKER. Thank you very much.

The CHAIRMAN. Incidentally, we will meet at 9:30 on Wednesday morning as a committee to act on your nomination.

Mr. VOLCKER. Thank you.

The CHAIRMAN. The committee stands adjourned.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[Additional material ordered inserted in the record follows:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: VOLCKER (LAST) PAUL (FIRST) A. (OTHER)

Position to which nominated: Chairman, Board of Governors of the Federal Reserve System

Date of nomination: 7/25/79

Date of birth: 5 (DAY) 9 (MONTH) 27 (YEAR) Place of birth: Cape May, New Jersey

Marital status: Married Full name of spouse: Barbara Marie (Bahnson) Volcker

Name and ages of children:

Daughter: Janice Louise Volcker - 24

Son: James Paul Volcker - 21

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Teaneck High School	1939-1945		
Princeton University	1945-49	B.A.	
Harvard University	1949-51	M.A.	
London School of Economics	1951-52		

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Administration Fellow - Harvard University

Rotary Foundation Fellow

Phi Beta Kappa

Fellow, National Association of Business Economists

William F. Butler Award, N.Y. Chapter of NABE

Fleming Award, Alexander Hamilton Award, Exceptional Service Award (U.S. Treasury), General Leslie Graves Award

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
Council on Foreign Relations	Bd. of Directors	1975 - present
American Council on Germany	Bd. of Directors	1975 - present
American Friends of London School of Economics	Bd. of Directors	? - present
Rockefeller Foundation	Bd. of Trustees	1975 - present
American National Red Cross Endowment Fund	Bd. of Trustees	1972(?)- present
Mayo Clinic/Foundation	Bd. of Trustees	1979
Trilateral Commission	Member	1975 - present

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

8/75 -	President-Federal Reserve Bank of New York, 33 Liberty St., N.Y., N.Y. Central Bank President
9/74-7/75	Princeton University, Princeton, N.J. - Senior Fellow (Also did consulting work)
1/69-7/74	U.S. Treasury, Washington, D.C. - Under Secretary
1965-1969	Chase Manhattan Bank, N.Y., N.Y.-V.P. & Director of Forward Planning
1961-1965	U.S. Treasury, Washington, D.C.-Dir., Office of Financial Analysis and Deputy Under Secretary
1957-1961	Chase Manhattan Bank, N.Y., N.Y. - Financial Economist
1952-1957	Federal Reserve Bank of New York, 33 Liberty St., N.Y., N.Y. - Economist, Special Assistant
EARLIER	Summer jobs - including positions at U.S. Treasury and Federal Reserve Bank of New York

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

See Employment History
Also: Department of Commerce Balance of Payments Advisory Committee (1967-1968)
Advisor to Commission on the Reorganization of the Government for Foreign Policy ("Murphy Commission") (1974-1975)
Department of State Review Board for Career Ministers (1975)

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

I have had a sizable number of articles, lectures, reports and speeches published as or in books, in professional journals, in other periodicals, or in official publications, but have no current listing.

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

None

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See attached

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes, except to extent inherent in new position.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

No

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

Pension rights from service at Federal Reserve Bank of New York.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None, to my knowledge.

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None. Congressional contacts have been in connection with official duties.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

Remove source of concern (none to my knowledge).

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

Defendant in suit brought by Senator Riegle against Presidents of Federal Reserve Banks serving on Federal Open Market Committee.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

EXCERPTS FROM
PAUL A. VOLCKER
BIOGRAPHY

Paul A. Volcker, president and chief executive officer of the Federal Reserve Bank of New York, joined the bank on August 1, 1975, completing the unexpired portion of a five-year term of his predecessor, Alfred Hayes. He was appointed to a full five-year term on March 1, 1976.

Before joining the New York Fed, Mr. Volcker, 51, pursued a varied career in public service and banking.

From 1969 to 1974, he was under secretary of the Treasury for monetary affairs. His five-and-a-half-year tenure under three secretaries, covered a period of rapid change in international and domestic financial affairs.

Mr. Volcker played a central role in developing international financial initiatives by the United States during the transition from fixed to floating exchange rates and acted as the principal U.S. negotiator throughout the period.

A number of important innovations were introduced during Mr. Volcker's term of office in the area of domestic financing, including the auctioning of Treasury notes and bonds and greater centralization of U.S. agency borrowing.

After leaving the Treasury, Mr. Volcker became senior fellow at the Woodrow Wilson School of Public and International Affairs at Princeton University for the academic year 1974 to 1975.

Previously, Mr. Volcker served in a variety of positions with the Treasury, Chase Manhattan Bank, and the New York Fed.

His experience with the New York Fed began in the summers of 1949 and 1950, when Mr. Volcker worked as a research assistant in the research department. In 1952, he returned to the New York Fed as an economist in the research department and, in 1955, he became a special assistant in the securities department. Two years later, he resigned to become a financial economist at Chase Manhattan Bank.

In 1962, he joined the Treasury as director of the Office of Financial Analysis and, in 1963, was appointed deputy under secretary for monetary affairs. In 1965, he rejoined Chase Manhattan as vice president and director of forward planning.

As under secretary of the Treasury, Mr. Volcker also served as a member of the board of the Overseas Private Investment Corp. and the Federal National Mortgage Association.

He is currently a member of the board of directors of the Council on Foreign Relations, the American Council on Germany and the American Friends of the London School of Economics. He also serves on the board of trustees of the Rockefeller Foundation and the American National Red Cross Endowment Fund.

Among various awards in the course of his career, he has been named as one of the 10 Outstanding Young Men in Government; received the Alexander Hamilton award, the highest award given officials of the Treasury Department, and received the first William F. Butler award from the New York Chapter of the National Association of Business Economists.

Mr. Volcker earned a master of arts degree in political economy and government from the Harvard University Graduate School of Public Administration in 1951 and a bachelor of arts degree, summa cum laude, from Princeton in 1949. From 1951 to 1952, he was a Rotary Foundation Fellow at the London School of Economics.

He is married, has two children and lives in Manhattan.

September 1978

ANSWERS TO
QUESTIONS FOR THE RECORD FOR MR. VOLCKER
FROM SENATOR PROXMIRE

1. Has the White House counsel reviewed your financial statement for any potential conflicts of interest?

The White House counsel has reviewed my financial statement for any potential conflicts of interests, and I am informed such counsel has concluded no actual or potential conflicts of interest exist.

2. If you are confirmed in the position as a member of the Board of Governors of the Federal Reserve System, will you agree to appear before the Committee or any other appropriate Committee of the Congress and testify without reservation?

If confirmed in the position as a member and Chairman of the Board of Governors of the Federal Reserve System, I agree to appear before the Senate Committee on Banking, Housing, and Urban Affairs or any other appropriate committee of the Congress and to testify without reservation.

3. Do you favor reserve requirements on repurchase agreements? Do you see the need for reserve requirements on Eurocurrencies imposed not only by the Fed, but also by foreign central banks? Many bankers have complained about the rapid growth of the commercial paper market. Do you see the need for the Fed to have some control over the expansion of the commercial paper market?

Repurchase agreements entered into between a bank and its customer enable the bank to expand its loans and investments while providing the customer with a highly liquid investment that can readily substitute for demand or short-term time deposits. Deposits of banks are, of course, subject to reserve requirements set by the Federal Reserve, and this facilitates control over money supply and bank credit. Because repurchase agreements are substitutable for deposits from the standpoint of some depositors, and are at least a partial substitute for deposits from the standpoint of the issuing bank, there is a clear argument for subjecting them to reserve requirements on grounds of both monetary control and equity. Indeed, repurchase agreements on all bank loans and investments except U.S. Government and Federal Agency securities have been subject to reserve requirements for some time.

Whether reserve requirements should in practice be extended as well to RP's on U.S. Government and related securities would depend on weighing the benefits for monetary control against the possible costs to the public from reducing the attractiveness of U.S. Government securities to banks and from placing banks who deal in those securities at a disadvantage relative to nonbanks. At present, the question is further complicated by the differential treatment of member and nonmember banks.

As you know, the Board has recently asked for public comment on such a reserve requirement proposal. While heretofore I have believed the costs of extending reserves to RP's outweighed the benefits, at least so long as the membership issue is unresolved, I will of course want to review the situation in the light of public comment on recent proposals, the changing economic situation, and legislative action with respect to reserve requirements.

Reserve requirements on Eurocurrencies are one among a number of issues--including prudential measures, such as monitoring liquidity and capital ratios, and better statistical reporting--now under study within the Federal Reserve and elsewhere. So far, I doubt the Eurocurrency markets have been a major source of inflationary pressure or currency instability independent of other factors at work, including national policies, mainly because the Euro-markets are closely linked to domestic markets. However, the studies underway should throw further light on that issue. Moreover, I do believe competitive imbalances between the Euro-markets and national markets may artificially speed the growth of the former, with potentially undesirable consequences for monetary control and international financial stability. Whether or not reserve requirements are a practical and useful means of dealing with the competitive imbalances and potential control issues will depend in major part on the form of domestic legislation on reserve requirements and the attitudes and policies of other countries concerned, since the effectiveness of reserve requirements would depend upon action by a sizable number of countries. I would also note, reserve requirements have to be judged against the constructive role thus far played by the Euro-markets in intermediating between borrowers and lenders in a period of large worldwide payments imbalances.

With regard to the commercial paper market, I do not anticipate the need for the Federal Reserve to have direct control over its expansion. Interest rates in that market are fairly closely related to the Federal funds rate--the interest rate most directly affected by monetary policy operations--and in that way Federal

Reserve policy indirectly influences the commercial paper market. It should be noted, however, that, as in the case of Euro-dollars, the expansion of the commercial paper market has been influenced by reserve requirements on large short-term time deposits offered by banks, which have made it costly for banks to raise funds in the maturity areas favored by commercial paper issues. Consequently, there is an incentive to channel a larger portion of funds outside the banking system which is under the direct surveillance and control of the monetary authorities. Over the longer run, it does seem to me structurally desirable that banks be able to compete on more equal terms, thereby spreading market risk over a broader range of lenders. Consequently, the issue is raised of the nature of reserve requirements (if any) on time deposits of banks because no comparable requirement is placed on the commercial paper market.

4. Starting in 1975, about the time you became President of the New York Fed, the Federal Reserve has reported its plans and objectives for monetary policy to the Congress on a regular basis. The reporting requirements are now part of the Federal Reserve Act. Although they have gone through some considerable change, the requirements still focus on target ranges for the monetary and credit aggregates. The most recent report contained an economic forecast which represented a consensus of the Board, an addition to the reporting process that I think is helpful and important and which hopefully will be continued. How do you view the monetary policy oversight process? Do you have any suggestions for improving the flow of information on monetary policy?

The monetary policy oversight process has, from my previous vantage point, worked well. The emphasis on projected "targets" or "growth ranges" for the monetary aggregates as a means of facilitating communication and policy intentions, has seemed to me particularly useful, and that innovation of course owes much to your Committee. I have no specific suggestions for improving the flow of information on monetary policy at this time, but I do look forward to working closely with your Committee in this area. While I have some concern that undue emphasis on economic forecasts may inadvertently suggest a precision in assessments of the outlook that is not possible--and may occasionally be counterproductive in terms of developing policies that take suitable account of inevitable uncertainties--I am confident that as we gain experience, further improvement can be made in communication and the policy process.

VIRGINIA TAXPAYERS ASSOCIATION P. O. BOX 663 LYNCHBURG, VA. 24505

Statement by Kenneth White, President

Opposing Confirmation of Paul A. Volcker as Federal Reserve Board Chairman

before

U. S. Senate Committee on Banking, Housing, and Urban Affairs

July 30, 1979

Mr. Chairman, my name is Kenneth White and I am President of the Virginia Taxpayers Association, a federation of local taxpayer organizations and individuals from all 10 congressional districts in Virginia. The Virginia Taxpayers Association was organized six years ago as a broad-based taxpayer organization working to reduce government taxes and spending at all levels of government -- local, state and federal -- and to preserve the freedom of the individual American citizen. The VTA has become widely known not only across Virginia but among followers of the taxpayer movement all over the United States, and reports of our activities have been carried in publications printed in many other states. On June 21 of this year the Virginia Taxpayers Association presented testimony before the Senate Judiciary Committee regarding the cost of a proposed federal paid holiday on Martin Luther King's birthday January 15, and following our appearance we were publicly commended for our testimony by Senator Strom Thurmond, the acting committee chairman. Since the passage of Proposition 13 in California last year, we have taken the lead in Virginia in working for similar legislation and for the right of initiative and referendum in our state, as already exists in 23 other states, and our positions have received comment and discussion in several newspaper editorials. A Lynchburg, Va. News lead editorial specifically favoring our VTA position on the Panama Canal treaty was reprinted in the Congressional Record July 18, 1978. We regularly testify a number of times each year before the Virginia General Assembly, we have assisted in the continuing defeat of the so-called Equal Rights Amendment in the Virginia legislature, and we have appeared on television programs across the state in a leadership role on the subject of state general obligation bonds, among many other activities. We submit that we are a recognized spokesman for the fast-growing grass-roots taxpayer movement in this country, and that our views are widely shared and supported by millions of American taxpayers.

The appointment of Paul A. Volcker to serve as Chairman of the Federal Reserve Board is not just a personnel question, it is also a financial policy and tax question. An oft-quoted statement which I believe all of the members of this committee will agree with is that "inflation is the cruelest tax of all." Inflation certainly is a tax, and like other taxes, it can be said to be made in Washington. As you all know, inflation is the number one problem for most Americans today. Parenthetically, just this past week, on July 26, the Virginia Taxpayers Association encountered an additional reason to become concerned about inflation, when Governor John Dalton announced that the soaring inflationary spiral may force him to recommend a bigger-than-usual wage boost next year for some 80,000 state employees, which of course will require increased tax payments from Virginia taxpayers.

We are firmly convinced there can be no informed consideration of inflation without covering the all-important role of the Federal Reserve

System, which Mr. Volcker has been proposed as the head of./ The president of the Federal Reserve Bank of St. Louis, Darryl R. Francis, admitted on May 22, 1974 in a speech in Minneapolis that the growth of the money supply, which the Federal Reserve supposedly regulates, "has been the primary cause of the acceleration in the average rate of inflation."

More bluntly, the noted author and financial analyst, Dr. Martin Larson, in his 1975 book, "The Federal Reserve and Our Manipulated Dollar", said of the Federal Reserve: "......by financing the huge deficits of the federal government and emitting a flood of fiat currency, it has created and continues to create irrepressible pressures for inflation, which, unless curbed and terminated, will bring this nation to economic ruin."

So the question before this committee today is whether the President's nominee, Mr. Volcker, will in fact do anything to prevent the Federal Reserve from continuing to create these irrepressible and intolerable pressures for inflation, and we submit the record shows that he will not, and therefore should not be confirmed as Chairman of the Federal Reserve Board.

The Associated Press news story of July 26 announcing Mr. Volcker's nomination stated that: "While at Treasury, he helped to engineer the two formal devaluations of the U. S. dollar in 1971 and 1973......."
In other words, the Associated Press is openly telling us that Mr. Volcker as Undersecretary of the Treasury for Monetary Affairs deliberately helped to destroy the value of our dollar, to increase our taxes, rob us of our property and inevitably increase the price of almost everything we buy. And yet this is the man that is now being considered to head the Federal Reserve Board!

Incidentally, this same Associated Press news story also said: "The Federal Reserve Board chairman is sometimes referred to as the second most important person in government after the President, because of the considerable influence the board has over the nation's economy, through its manipulation of interest rates."

This committee must be informed in no uncertain terms that the arrangements under which this nomination is being considered by Congress are absolutely intolerable. To schedule a brief confirmation hearing for a position as important as this only three working days after the nomination was announced gives most concerned citizens and organizations totally inadequate time to research the background and qualifications of the appointee and present this essential information to the reviewing committee. Moreover, to take the position, as this committee openly has, that "we're going to push this confirmation through since there is no opposition" --- when the committee schedule has been designed to quickly prevent emergence of any opposition --- is a clear indication that this committee realizes there are skeletons in the Federal Reserve and Paul Volcker closets which the committee does not want to uncover, or at least does not want too many people to know about.

The Virginia Taxpayers Association reminds this committee that the Chairman of the Federal Reserve Board is not simply a member of the President's Cabinet whom the President is supposedly entitled to choose on some pretended basis of "compatibility" between the President and one of his assistants.

Instead, the Federal Reserve Board is a creation of Congress itself --- although the Virginia Taxpayers Association along with many other

Americans is satisfied this creation is nowhere sanctioned by the Constitution --- and is supposed to be entirely independent of the Executive Branch. Congress alone therefore has the final responsibility of deciding who the Federal Reserve Board Chairman shall be. The showing to date that Congress does not want to take this immense responsibility seriously, at a time when members of Congress themselves assuredly know of the intimate connection between the Federal Reserve Board Chairman and inflation, tells the public unmistakably two things: (1) that Congress has no intention of doing anything basic whatsoever to really solve the horrendous inflation situation facing Americans today; and (2) that Congress wants to continue the Federal Reserve inflation cover-up.

It was the Virginia Taxpayers Association that originated the statement: "Taxpayers are the boss", which was carried on the national Associated Press wire last year and shown on network television following the success of Proposition 13, and we believe we are competent to advise this committee that if Congress continues to demonstrate unwillingness to do its duty in this all-important area of inflation, the five or six million Americans who are now refusing to file income tax returns for one reason or another or to pay income taxes will steadily increase in number until they become a formidable political force. If this is what you gentlemen want, you may perhaps continue to ignore the taxpayer movement, but we do not recommend such a course.

Getting back to Mr. Volcker, it was he who was quoted as saying in Paris July 24, 1969: "Well we got this thing launched", referring to the Special Drawing Rights gimmick, which was described by the Wall Street Journal on October 7, 1969 in these words: "It was no mean trick to get most of the world's nations to agree to create a new reserve asset literally out of thin air......Paper gold is essentially a bookkeeping device, not a circulating medium", and again by the Wall Street Journal November 18, 1969: "Tricky little bookkeeping arrangement". This "tricky little paper gold arrangement" of Mr. Volcker's was designed to back up what the January 1979 Reader's Digest describes as our "phony money", and what the Virginia Taxpayers Association described as "really counterfeit currency" in our Senate Judiciary Committee testimony for which we were commended June 21. Or, as the new 1979 book, "Tax Target: Washington" by Gary Allen, with introduction by Howard Jarvis, puts it: "You thought you were carrying money around in your pocket? Actually, it is the unsecured and unredeemable debt of the government. We have switched from money to debt as a medium of exchange!" And so if Americans don't like our present "phony money" created by the Federal Reservw System --- and the recent increased flight to real gold at $307 an ounce proves that they don't --- Mr. Volcker can apparently be counted upon to create some different kind of "phony money" to back it up --- if this is what Congress considers "financial statesmanship". Mr. Volcker as president of the Federal Reserve Bank of New York seems to fit the pattern discussed in the St. Louis "Fed" Review of August, 1971 on page 24: "Those individuals who rise in central banks are people who can impress other people that they can keep their heads no matter what --- and no matter whether it is true or not."

It appears clear to us that a chief task of the Chairman of the Federal Reserve Board ought to be not only to stop such record increases in the money supply as occurred in the week ending June 6, but to plan for an orderly phasing out of unredeemable Federal Reserve Notes and an orderly phasing in of a constitutional currency in which Americans and all the rest of the world could justifiably have confidence. While Mr. Volcker undoubtedly has a great deal of experience, unfortunately his kind of experience is the opposite of what is needed today, and despite his recent "conservative rhetoric" there is no real evidence in his record that he is interested in the goal of a constitutional currency. We need instead the competence, ability and true statesmanship of the kind displayed by the late renowned Louis T. McFadden, a successful Pennsylvania banker and for 12 years chairman of the U. S. House of Representatives Committee on Banking and Currency, whose historic and penetrating analysis of the Federal Reserve System on the floor of the House on June 10, 1932 has been reprinted many times.

The Associated Press story that was referred to earlier says that the 1971 and 1973 devaluations which Mr. Volcker helped to engineer were "forced on the United States because of its weakening position in the international economy." Members of this committee are well aware that instead of being "forced on the United States", the basic 1971 monetary situation was in fact brought about by the Federal Reserve System, by Mr. Volcker and the other senior officials in the Treasury Department, and by the reckless deficit spending of Congress.

What taxpayers believe they are entitled to know is the connection between the devaluation which Mr. Volcker helped to engineer, and which was officially announced by President Nixon August 15, 1971, and the top secret Bilderberg Conference which had been held in Woodstock, Vermont April 22 to 25 of that year, and which had been hosted by Mr. Volcker's backer and former boss at the Chase Manhattan Bank, David Rockefeller. The Boston Globe of April 23, 1971 said that particular Bilderberg Conference was also attended by then Presidential Assistant Henry A. Kissinger and Senator Adlai Stevenson 3rd (who is a member of this Senate Committee on Banking, Housing, and Urban Affairs), and other sources listed as additional attendees Rep. Henry S. Reuss, now chairman of the House Committee on Banking, Finance and Urban Affairs, Prime Minister Trudeau of Canada, Baron Edmond de Rothschild of France, and representatives of England, Germany, Italy, Switzerland, Belgium, Norway, Sweden, Denmark, the Netherlands, Finland and Turkey. Prince Bernhard of the Netherlands, official chairman of the secret conference, would only reveal publicly that the prime topic of the conference was "the possibility of a change of the American role in the world and its consequences", and an aide to Rep. Peter H. B. Frelinghuysen, of New Jersey, who also attended, admitted that "international and monetary policies" were discussed. The logical inference is that in helping to engineer the 1971 devaluation, Mr. Volcker as Undersecretary of the Treasury was in fact carrying out decisions made at the secret and <u>privately sponsored</u> Bilderberg Conference, and we submit that, in view of the importance of the many persons who attended that conference, this conclusion would be quite difficult to refute without <u>detailed testimony</u> on the witness stand of a <u>number</u> of those who attended the conference. We know of no section of the Constitution which authorizes U. S. government officials to take instructions from private organizations, and we believe this alone would be sufficient to disqualify Mr. Volcker from Senate confirmation to any post requiring such confirmation.

Another serious subject requiring further consideration is the glaring confusion and lack of understanding in the area of monetary matters on the part of the President who appointed Mr. Volcker, and whose judgment in such appointments is therefore highly suspect. This confusion and lack of understanding is clearly demonstrated by the President's appointment of G. William Miller to be Secretary of the Treasury, with whom the President would presumably be "compatible". Mr. Miller's record as Chairman of the Federal Reserve Board shows that instead of being knowledgeable, competent and correct in his policies, he has actually been an outstanding failure, since the inflation which he as Federal Reserve Chairman is supposed to minimize has in reality skyrocketed to record levels during his term of office. We in the Virginia Taxpayers Association are sufficiently informed to know that inflation is not just "created by the OPEC nations" but actually comes from Washington, and that whenever the U. S. money supply is increased as fast as it has been, thereby lowering the value of all so-called "dollars", any foreign nation selling oil to the U. S. must continually in its own self defense raise the price of oil as measured by these ever-depreciating "dollars". Mr. Miller's recent "conservative-sounding" warnings about the risks of inflation, we believe, are largely designed to mask and cover up his own record of failure to slow down inflation. And if the President wants as his own Secretary of the Treasury such a conspicuous failure as a monetary and financial leader, what else may we reasonably expect from his appointment of Mr. Volcker to be Federal Reserve Chairman? It should further be noted that the Associated Press story announcing the Volcker appointment says: "....he has had a major influence over economic policy for some time" (emphasis added). Can any member of this committee think of any major lasting success in economic policy which the United States has enjoyed in recent years, and for which Mr. Volcker might be responsible? On the contrary, we submit that it appears to most American taxpayers and consumers that economic conditions have pretty consistently been going down hill.

There is neither time nor space here to review Mr. Volcker's astonishingly incorrect prediction early in this decade that the U. S. "will accept a new international currency by the summer of 1973"; his reported covert commitment to Japanese officials in 1973 not to invoke the Anti-Dumping Act, as had been threatened, against the influx of cheap Japanese imports, at a time when the U. S. trade deficit with Japan was already running at more than $4 billion a year; his membership in the internationalist one-world Council on Foreign Relations; or his connection as a special consultant to the Trilateral Commission, about which the label "international conspiracy" has been used so many times that U. S. News & World Report among many others sought to deny that any conspiracy existed. Present "approved terminology" regarding the privately organized Trilateral Commission --- founded by David Rockefeller and early including Jimmy Carter as one of its members --- as applied in an Associated Press news story of July 26, 1979, is merely that "Carter has used (the commission) as a recruiting ground for his administration."

In summary, the Virginia Taxpayers Association believes that, despite the encomiums of praise heaped on this nominee by all "establishment" sources, there is more than enough evidence to show that Mr. Volcker's "experience" will not in fact be beneficial to the United States or contribute to the strength of its monetary system, that on the contrary inflation can be expected to accelerate at a dangerous rate under his administration, and that his nomination as Chairman of the Federal Reserve Board should therefore be rejected by the United States Senate.

# # #