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MD INTERVIEW

AN INTERVIEW WITH PAUL A. VOLCKER

Interviewed by Perry Mehrling
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Paul A. Volcker has spent most of his life in public service, at the Treasury under President Kennedy (1962–1965) and then as Undersecretary for Monetary Affairs under President Nixon (1969–1974), as President of the Federal Reserve Bank of New York (1975–1979), and finally as Chairman of the Board of Governors of the Federal Reserve System under both President Carter and President Reagan (1979–1987). Born in 1927, his world view was formed by childhood experience of the Great Depression and World War II, times of great national trial that led ultimately to recommitment and reconstruction. He went into public service in order to be a part of the rebuilding effort, but it was his fate instead to be involved mainly in managing pressures that would ultimately lead to the breakdown of the Bretton Woods system internationally and the Glass–Steagall banking system domestically. Consequently, there is some sadness today when he looks back on his career, but there is also a sense of accomplishment. In spite of everything, there was no depression and there was no world war. The possibility and hope for progress in years to come remains alive.

The interview took place in Volcker's office at Rockefeller Center in New York City. His fourth-floor windows look out over the sunken plaza to the gold-leafed statue of Prometheus stealing fire from the gods, and then on farther to the elegant GE building, which is familiar to anyone who has visited New York. Over the front entrance it is just possible to see the inscription adapted from Isaiah 33:6, "Wisdom and Knowledge shall be the stability of thy times." It strikes me as an appropriate inscription for the building, reminding one that this most beautiful complex was built in the years of the Great Depression. Today, with the forthcoming interview in mind, it reminds me also of the stakes involved in the conduct of monetary policy.

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Mehrling: I take it that you've always been interested in public service, given your childhood in the Depression and the example of your father who served as city

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Figure 1. Paul A. Volcker.

manager of Teaneck. What's less clear is, why money? How did you get interested in devoting public service to the problems of the monetary side of the economy?

Volcker: Partly, these things happen by accident. My first introduction in an academic sense was a course in money and banking I took from Friedrich Lutz at Princeton. He was a fairly well-known professor at that time, a very good lecturer, always very logical and straightforward. His course somehow intrigued me because it seemed less flaky than a lot of economics. At that time, I had the illusion that balance sheets balance, that a number for loans, or a number for

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something else, really was an accurate number. It just somehow—I can't say it seemed more logical—it intrigued me.

And then I wrote my thesis on the Federal Reserve, again sort of by accident. I'm a great procrastinator. I was a half year out of cycle because when I first went to Princeton it was three terms a year—this was what they did during the war. I had to write a senior thesis, and in my procrastinating way during the spring semester, which was the first semester of my senior year, I sat around, floundering around, not knowing quite what to write about, and I didn't do anything for that whole semester. I don't know where I got this idea of the Federal Reserve, but it seemed simpler and more straightforward to some degree than other things and, as I say, I was intrigued by money and banking. Anyway, somehow Frank Graham was assigned to me as a supervisor.

I was never close to professors. I thought they never had time for me, and I didn't have much interaction, but then I got assigned one of the leading professors in the economics department! I remember visiting him when I was first assigned, probably late in September, and I said that I was a little bit worried about getting this done, and he said, "You've got plenty of time." "I'm worried," I said, "because I graduate in January!"

After that, I'll never forget how helpful he was. When I got done reading and organizing, I began writing, probably in December. I would sit away in my little carrel scribbling out chapters, and I would give them to him, long chapters written in longhand. He would read them, make some comments, and give them back to me very promptly. You can't imagine a professor doing that now! He would insist upon having it typed, not having to give it back in a few days, much less the next day.

Mehrling: The thesis was about the origin of the Fed, the history of the Fed?

Volcker: Well, it goes back through the history, but it was more on current policy. Two or three chapters on history, monetary doctrine I suppose, real-bills doctrine, all that stuff. Years later, I went back to Princeton to give a lecture, and some student said, "Well, I read your thesis and you say we ought to abolish the independent Federal Reserve. What do you have to say about that?" All I thought to say at the time was that one's education continues after college! Later, when I went back and looked at what I had written, in fact what I said was, if they're not going to do a better job than they are doing now, and they are acting under the thumb of the Treasury, which they were in those days, there is no point in being independent. You might as well be part of the Treasury.

Mehrling: Then you went off from there to Harvard, to the Littauer School of Public Policy. You did that right away?

Volcker: Well, I graduated in January or February, so I had 6 months or whatever it was. I was interested in public service, so I went down to Washington just cold, wandering around to a few agencies asking whether they had a job, including the Federal Reserve. They told me they didn't. I used to tell a joke about it, that I was turned down for a job at the Federal Reserve! I just wandered in cold, and actually I did get interviews with a few very senior men, but you know they didn't want to hire somebody who was just going to be there a few months. I eventually ended up at the Federal Reserve Bank of New York, so that was fine, my first real job. After that I went on to graduate school.

Mehrling: When you were at the Littauer School, that was when you met Alvin Hansen? Did you take classes with him? Did you take that famous seminar with John Williams?

Volcker: Well, Hansen had a one-semester course. I think it was called Money and Banking. It was a very clear logical didactic dissertation of Keynesian theory. It was straight out of the *General Theory*. We read the *General Theory* comprehensively. Hansen was a very powerful teacher because it was all so clear in his mind.

Williams had the second half of the course, and everything was cloudy, always questioning; he didn't put numbers around everything. It was a great contrast. They also had this fiscal policy seminar. It was very well known, but I didn't normally attend it. I don't know why. Maybe I considered it more advanced.

Mehrling: So you learned Keynes from Hansen, and fuzzy from Williams. Which style did you like better?

Volcker: I remember very well Hansen laying this all out very logically and straightforwardly. One of the books we read was by Larry Klein, which was heavily econometric, *The Keynesian Revolution* I guess it was called. I can remember viscerally reacting, partly to Hansen but reinforced by Larry Klein—who is a wonderful guy, I later discovered—but thinking it can't be all that simple. You know, the world doesn't operate this way. They seemed to encompass it all in this nice consumption function, but I just had this visceral suspicion that the world was a lot fuzzier than laying it out quite so neatly as they did.

I had gone through Princeton and I did a lot of economics there. I remember taking as an undergraduate the advanced theory course even when I was a freshman or sophomore. There was one course they had then, called Business Cycles, but I can't remember the word Keynes ever being pronounced. We certainly did not learn about the *General Theory*. My introduction was when I went to Harvard, because at Princeton they were a bunch of Austrians. They were teaching us Bohm Bawerk and the Austrian school. What von Morgenstern mostly taught in the advanced theory course came straight out of that school. I skipped over the elementary economics course, but even that I think didn't have much Keynes.

Mehrling: Your mention of business cycles reminds me of your 1978 Moskowitz Lecture, "Rediscovery of the Business Cycle," where you say fine-tuning basically is a thing of the past and not only that but also maybe the long cycle has turned down.

Volcker: Is that what I said? I said the business cycle is kind of a psychological affair, didn't I?

Mehrling: Yes, you did say that. Yes. "Greed, fear, and hubris."

Volcker: Did I say that? I've concluded in my old age that hubris is a besetting human sin, but I didn't know I was saying it then. I still say that in my recent speeches!

Mehrling: I wonder about the extent to which that view of business cycles in 1978 comes from your Princeton training, whether it came from Hansen, or what?

Volcker: Well, it certainly didn't come from Hansen. There wasn't much hubris and fear and greed in his theories. It was all more from observing markets at Chase, my intellectual background from sitting at the trading desk in the Federal Reserve, from sitting in banks in New York.

Mehrling: We'll get to that in a minute, but before that, you went to the London School of Economics, right?

Volcker: Well, I didn't spend a lot of intellectual time at LSE. I was supposed to be writing my thesis, but I found London a little distracting.

Mehrling: I can understand that!

Volcker: But it was useful intellectually in one respect. I'm sorry I never—well, I don't know that I'm really sorry I didn't write a thesis. The primary thing I did at the London School of Economics was take a graduate banking seminar, a monetary seminar from Richard Sayers. It consisted mainly of him bringing in people from the City of London or otherwise, from government, talking a bit about the real world of banking and monetary policy in Britain, which was of course an interest of mine at the time. The thesis was supposed to be on the avenues of transmission of monetary policy, a contrast between Britain and the United States: the United States with a unitary banking system, very diffuse and diverse; Britain with at that point I guess five big banks and two pretty big banks. This was back in the days of lending and credit controls—consumer credit controls, secondary reserve requirements, and primary reserve requirements, all that administrative intervention. That was very much bound up with monetary policy and attempts to deal with the business cycle.

I had a fellowship from Rotary. It amounted to quite a lot of money by student standards. Also, it gave you entree to the Rotary Clubs, wherever you traveled, which turned out to be a great thing. Here I was, this American student interested in banking, and I finally decided that I'd better do something. With my Rotary Club entree and with Sayers' help to some extent, I could go around England interviewing bankers, including the heads of some of the big banks. Hopping around outside of London, I got a pretty good view in a couple of months of how the British banking system worked. I went to the Bank of England and the Treasury, too. I could have written a good thesis! I did have an opportunity to get a pretty good view of how monetary policy functioned and the institutional side, but otherwise I was impatient about the life of a scholar.

Mehrling: So you didn't read at that time the classic banking texts, for example, Bagehot's *Lombard Street*?

Volcker: Well I read some of Bagehot, and I read a lot of Hawtrey. I remember I read a lot of Hawtrey.

Mehrling: *Currency and Credit*? *The Art of Central Banking*?

Volcker: I don't remember the names of the books, just being in London. In those days I used to read the *Economist* and the *Financial Times*, so I kept up with what was going on in the money markets.

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Mehrling: So already you're getting your knowledge about how the monetary system works from looking at it, instead of from reading books about it.

Volcker: Yes, well you know I did some of both. I didn't regularly attend Lionel Robbins' lectures, which were considered the core of LSE economics. They were much more theoretical and abstract than Sayers' seminar. But to put that in perspective, I'd had a good deal of theory at Princeton and Harvard, at least as advanced as that in Robbins' seminar.

I remember there was this one banker who came down from the City of London to the Sayers seminar. He pointed out that there wasn't much international finance in those days. This was in the aftermath of World War II and there were controls, destruction, and lack of confidence. But, he said, someday it's going to change and international lending will start again. He said there was one thing that he'd learned from experience. If there's a lot of international lending, it had better be done in the banks. Then in the end, when the crisis comes, as it inevitably will, it will be more manageable than if the lending is done in the open market, because you can never get the creditors together when they are diffused in the open market. I've never forgotten that. It happens to be true! It was a lot easier to manage international financial crisis in the eighties than in the nineties precisely for that reason.

Mehrling: I want to get to that, but the next stage of the education of Paul Volcker was the New York Fed. You got a job there under Robert Roosa, then moved on to the open-markets desk. Am I right that that was an education?

Volcker: Well, if you're going to be chairman of the Federal Reserve Board, I had a pretty good education! The first part of the time I was at the Federal Reserve Bank of New York, I was involved in forecasting factors affecting banking reserves, highly technical stuff but a direct input into open-market operations. I used to know the Federal Reserve statement and all that went into changes in bank reserves backward and forward: Federal Reserve float, currency in circulation, Treasury cash—daily movements, seasonal movements, weekly movements. I was expert in that, and it gave me insight into the money market from a technical and intellectual standpoint. Then, I got the chance to go to the trading desk, and could observe the market in action. That was a rare privilege, unprecedented for an economist. In those days everything was much more hierarchical and constrained. The feeling was that unless you had been sitting on the trading desk for a long time you were not capable of talking to a government securities dealer and making a purchase or sale. You wouldn't use the right phraseology, you wouldn't have a market feel, and you would clumsily give the wrong signal. The fact that I was there at all meant that this had begun to change. Bob Roosa was there in a senior position, and he broke the dichotomy between the market operations and the economists at a management level. I was the first one to actually sit on the trading desk who was from an economics background.

My responsibilities were not all that enormous. I used to write endless reports, detailing exactly what the market did every day, and what the Federal Reserve did and why we did it. Some of it was dull, but I really did get a feeling for how financial markets worked, and what shaped attitudes, which most economists don't have.

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I began to realize the importance of expectations, watching the market move the most when there was very little trading. It jumped because of some psychological factor. You couldn't sit there watching the market every day without realizing that it was changing expectations that usually moved markets on a daily basis.

In those days if you got a move of 4/32nd's in the government securities market, it was considered a turbulent day. Of course, now that is all changed. Then you couldn't imagine the market moving a point in a day, which it does rather frequently nowadays.

Mehrling: So the next stage was Chase Manhattan?

Volcker: That was good training, too. All this money market stuff which I'd seen from the technical and Federal Reserve viewpoint, I could see it from the inside of a big bank. I used to make projections for the bank—how our deposits would change, how much we had to make loans, the implications for interest rates and lending policy. In those days, the deposit base was constricted, there were official interest-rate limitations, the negotiable CD hadn't been invented, and other restrictions were still in place. I provided a liaison between the economics department and the rest of the bank, at least for financial analysis.

Also, I did a lot of work for the Commission on Money and Credit, partly because David Rockefeller was both president of Chase and a member of the Commission. *De facto*, I was almost an official staff member. That was interesting because it brought me into contact with some of the leaders of the profession and the leaders of the business community that were on the Commission. Among other things, I came into contact with Marriner Eccles.

Mehrling: I think of your education as ending and your public service career beginning in earnest in 1962, when you go to the Treasury. Is that what it felt like at the time?

Volcker: In retrospect, I think you are right. I don't know how old you are, but probably. . . .

Mehrling: Forty.

Volcker: Well, that period may all seem ancient history to you. It is a little hard to reconstruct for somebody your age the feeling that existed when Kennedy was elected. Before that, the United States emerged from World War II feeling king of the world, confident and exuberant. We won the war, and defeated the great evil. Beyond that, as the clear leader of the world, and certainly the economic leader, there was a real excitement about working in government. That's where the action was, and that's where a lot of able people wanted to be. That was exciting. That initial enthusiasm maybe got dulled a bit during the Eisenhower years, but then this handsome young fellow came in, full of zest, and confidence, and leadership for America. "We'll bear every burden and we'll solve every problem." I was caught up in it, along with many in my generation.

In the second Kennedy year, I had the opportunity to go to Washington because of Bob Roosa who had become Treasury Undersecretary for Monetary Affairs. I remember I was worried they were going to solve everything before I could get down there! It was a great feeling of challenge and excitement. You felt part of something important. I've always had a feeling about government that way, because of the way I grew up. But this was a great opportunity, all the more so because the Treasury was in a key position and Bob Roosa was the intellectual force.

Mehrling: Reading through your speeches, one of the things I noticed was your very consistent interest in the international monetary order, beginning already in 1962 with the first little cracks around the edges of the Bretton Woods system, and then escalating from there. This became a focus of your public service career?

Volcker: Well, I think that's probably right. You know it's hard to remember again how domestically focused economics teaching in the United States was in the forties, fifties, even in the sixties. In most economics courses, the international side was hardly mentioned. Any introductory textbook in those days would have a chapter or two at the end of the book, but the professor would often never get to it. And it was pretty superficial anyway. The international side was just not important to most people. Of course, the Keynesian analysis itself was very domestically oriented. I don't remember Hansen much getting into the international side of things. Unlike Williams, he was very, very domestically oriented.

I can remember with some embarrassment going to Chase from the very bureaucratic Federal Reserve Bank of New York, and assuming that all banks were equally bureaucratic. Of course, Chase was a bureaucracy too, but it was much less rigid than the Federal Reserve Bank of New York. I hadn't been there more than a month or two when I got invited up to the president's office to explain something I had written. I don't recall the subject, but when I finished, he sat me down and said he wanted to talk about his worries about the international situation, about the dollar, the balance of payments, the balance of trade. You know, the President of the Federal Reserve Bank of New York had never asked me to sit down in his office to talk about anything, much less a conversation as freewheeling as that!

I remember to my embarrassment that he was worried about our competitive position, which in those days was not considered a great concern by economists, but the president was very conservative, he was a banker, and he sensed things were becoming more difficult. This was in late 1957 or early 1958. I parroted the standard analysis at the time: "The more things we buy abroad, given the dollar shortage, other countries will spend the dollars as fast as they get them. Nothing to worry about there." Right about then it was that the gold stock began to go downhill. My reaction was pretty naive. This practical banker knew more about what was going on than I did!

I really got pulled into the international side when I was in the Treasury. Roosa was very international-minded. The Federal Reserve Bank of New York was the focus of international attention within the Federal Reserve, though I was not particularly involved when I was there. To the extent that there was an international concern, it was concentrated very heavily in the Federal Reserve Bank of New York, which had relationships with all the foreign central banks. You would not have found much interest in international affairs at the Board of Governors, certainly not at the Board itself, apart from the staff. The attitude at the Treasury was quite

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different as the convertibility of the European currencies was restored and the gold stock dwindled. Roosa was intent upon maintaining the stability of the dollar through thick and thin. Nobody in the Administration was permitted ever to raise any question about changing the exchange rate or changing the price of gold.

Mehrling: This was in 1963, with the interest equalization tax and various other administrative controls to shore up system. Was there much of a sense, as you recall, that this was going to be an ongoing problem?

Volcker: Well, in the Treasury at least, we were not sitting down speculating much about changes in the system. There was an implicit assumption through this period that somehow the fundamentals were going to straighten themselves out, that what was needed was a kind of temporary defense operation, that it was going to work out. It was only after Roosa left in 1964 that there was a willingness to think in terms of a more fundamental reform. The SDR negotiations only blossomed after Roosa left. He was opposed to all initiatives in that area, basically, I think, because of a feeling that psychologically further questions would be raised about the value of the dollar.

Mehrling: You left the Treasury shortly after Roosa, returned to Chase for a while, and then returned to the Treasury in 1969, under Nixon, when you were Undersecretary for Monetary Affairs, basically watching the Bretton Woods system dissolve little by little.

Volcker: Yep, agonizing over every step of the way.

Mehrling: And you fought every step of the way, and the people around you, that was the general attitude?

Volcker: Well, I had even had my suspicions, unvoiced pretty much in the Treasury in the earlier 1960's, that the dollar was a bit overvalued, though we were still running a trade surplus in those days. We were never sure, but I didn't take a lot of convincing that sooner or later we were going to have to do something about the dollar. I didn't relish the thought of being the Undersecretary for Monetary Affairs with direct responsibility in this area, to preside over the dissolution of Bretton Woods or devaluation of the dollar. But I was there and I came to the conclusion that was the game that had to be played.

I was still a little naive! You could see that something was going to have to be done. It was just a question of how much you could do at the time, how to go about it, how much exchange-rate change was necessary and could be negotiated, and whether you could pick the time rather than having it forced upon you. By the latter part of 1970, there was not much question in my mind that we were going to have to go off gold for a while, basically to make an exchange-rate change. We had already been through gold crises in the 1960's and the policy of sticking to the official price of gold had been stated and restated. The idea of reforming the system by doubling, or tripling, or quadrupling the price of gold would have been considered an enormous psychological defeat for the United States, as well as financially unsettling. I didn't think we were going to make a change in exchange rates without, in effect, suspending dollar convertibility into gold for a while.

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I always had in mind that this would be a relatively short transitional phase to a reformed system. I had some preliminary plans developed, but when push came to shove you couldn't interest anybody in that kind of planning. When the crisis came, President Nixon and Secretary of the Treasury Connally were willing to bite the bullet and take step one, suspending convertibility. They weren't willing to think much beyond that, which was a great frustration to me. But I was very naive to think you could reform the system very quickly.

Mehrling: What about Burns [Chairman of the Board of Governors of the Federal Reserve System]?

Volcker: Burns was different because Burns didn't want to do any of this. He was holding out to the end. I didn't think he had any realistic ideas as to how to reform the system, except he seemed to think we could negotiate a change in the price of gold without suspending convertibility. I could always talk to him, and we were allies on the domestic side of policy in a sense, though I didn't want to go as far as he did in advocating incomes policies and all that.

I had become convinced that when we floated the dollar or devalued—since we already had an inflationary problem—that the psychological repercussions of that would be severe and carry the threat of aggravating the inflation. We had this stagflation, and there was frustration in the country about what was then considered a high rate of inflation, with sluggish growth. I had become enamored with the idea that when the time came to float the dollar, we ought to also have a temporary price freeze, which was not so off the wall then as it sounds now. And that's what we ended up doing, but it lasted longer than the 90 days I had endorsed. All we needed to do, I thought, was to give expectations a chance to settle down. But 90 days became 2 years, or whatever it was, and monetary policy was much too loose.

Mehrling: So the thing blew up after.

Volcker: That's right. It's a sad story, engraved on my mind.

The attitude of foreign leaders of course was quite different. Much as they had criticized us and thought things were bad, when we finally acted to devalue the dollar, they were stunned and didn't know how to react. They were not at all prepared. At that point, we wanted some exchange-rate change, we wanted some more basic reform. But their idea of an appropriate exchange-rate change was very small—certainly well under 10%—and then simply put the old system back together again. That didn't make any sense, from our perspective. So there was a lot of confrontation.

Mehrling: So you are saying there was no real constituency for reform, and that America failed its responsibility to create such a constituency? I sense in your writings a touch of "city on a hill," American as a model, showing others the way.

Volcker: Well, it should be.

We went through this effort, first the devaluation and the Committee of Twenty. That took almost 2 years. It's now forgotten, but that was the effort to reform the system. I was in the Treasury and I was the American negotiator for reforming the system. I don't know how close we really came to an agreement. It was very

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difficult. But about the time when maybe an agreement was in sight, the oil price shock was used as an excuse to end the effort.

What remains from that reform effort is the Interim Committee and the Development Committee, the C25's. In fact, I take some credit for inventing the Interim Committee and the Development Committee as a means for improving the governance of the financial system and broadening the discussion to include developing countries. I can't say it all worked out as well as we hoped. The issues then were the same as those being pressed now. You know, nothing changes. You get older, the arguments are recycled! We wanted to broaden constituencies, so to speak. We wanted to bring the developing world into the discussions. And we wanted to get more intimate and more meaningful exchange of views. We wanted to get the Ministers and Secretaries, the politically responsible officials, more in contact with each other and more taken up with dealing with these problems on a face-to-face basis. The idea was that the Interim Committee should become the Governor's Committee and then eventually become the active governing body of the IMF. But we had so much bureaucratic resistance that that didn't happen *de jure*, but *de facto* it has happened to some degree.

Mehrling: And then you were on to the New York Fed in the aftermath of the oil shock, and then stagflation in earnest in the mid-seventies. What was it like to be President of the New York Fed at that time?

Volcker: Frustrating. It was a somewhat frustrating job, not so much on the policy side because I did have an opportunity to have as much influence on policy as anybody else in the Federal Reserve apart from the Chairman himself. But there had been a long, long history of personal and institutional rivalry between the New York Fed and Washington. Of course, over the years, New York lost relative influence, and the Bank's feeling of independence and autonomy within the system got whittled away. It just was frustrating administratively because the Board would intervene in what were essentially administrative decisions, big things to small things. For example, I was not particularly eager about building a new building, but I inherited extensive planning for a project at the New York Fed. The Board equivocated and then wanted to cancel it. That was a big issue. It didn't break my heart substantively because I felt they had good reasons, but it also entailed a lot of picky concerns. Things like reviewing the salaries of the senior officers were a constant source of friction. So there was a lot of frustration. On the other hand, there were benefits too. For all its frustrations, the presidency of the New York Bank is the second best job in the Federal Reserve System, or should be anyway, and I think the relationships are a lot smoother now. After all, I had both jobs!

Mehrling: And then, in the year or so before you went to the Board, it seems you started making speeches?

Volcker: The only two speeches I really remember are the Hirsch lecture on the international monetary system ["The Political Economy of the Dollar"] plus another one which was just on monetary policy, in 1978 at the AEA convention ["The Role of Monetary Targets in an Age of Inflation"]. The idea in that speech came to be labeled "practical monetarism" because, for the first time, I began

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Figure 2. Paul Volcker addressing MBIA conference.

rumbling about how it might make sense for the Federal Reserve to pay more attention to money-supply targets to discipline policy. It reflects the fact that I had begun thinking about how one could practically adopt some of these monetarist ideas, not just to create a constituency but actually to make policy more coherent and predictable.

Mehrling: That's interesting. You mention the Hirsch lecture, which is mainly about the changing position of the dollar in the international monetary system. As I remember it, one of your themes was about how international monetary stability is a prerequisite for economic growth. You suggest that the Depression of the thirties was to some extent, if not caused, certainly lengthened and made worse, by the breakdown of the international monetary system.

I wonder, as you look back at the decision in 1979 to embrace "practical monetarism" operationally, how important were these international considerations as compared to more purely domestic concerns such as inflation?

Volcker: As I look back on that decision, I think my concern was primarily domestic · · · well, it's all mixed up together; you can't separate. I guess that's become my theme, you can't separate them. That speech wasn't explicitly directed to the external side, but the external stability of the dollar is mixed up with it. I'm sure what stood out as my concern was the accelerating rate of inflation.

Mehrling: In terms of implementing this policy, you knew there was going to be pain associated with this, and you must have realized that in a democratic

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country you've got to find some way of getting people to go along, some way of explaining it to the people. Otherwise, they'll boot you out and you won't be able to do anything. The language of monetarism proved quite effective in that regard, didn't it?

Volcker: I used to rankle when some of the members of the Board who were all enthusiastic about this turn of policy would say, "Isn't this just a kind of public relations ploy to avoid being blamed for the rise in interest rates?" I never thought it was that, but a lot of people did think it was largely that. It was a very common thing to say that we just did it to obfuscate.

There is no question that I thought we needed to get support for a highly restrictive policy. You can always debate about raising interest rates, even by a quarter percent, which is almost not noticeable in the larger scheme of things. Recently, the Federal Reserve has acted to raise interest rates five times. We've raised interest rates five times by a figurative inch, and three of those times were to offset what had been done in the midst of the Asian crisis. On balance, we've had very little tightening. But we've had a great deal of focus on even small deliberate actions to change interest rates, and it's hard to explain how those higher interest rates affect inflation.

It always seemed to me that there is a kind of commonsense view that inflation is too much money chasing too few goods. You could oversimplify it and say that inflation is just a monetary phenomenon. There are decades, hundreds of years, of economic thinking relating the money supply to inflation, and people to some extent have that in their bones. So I did think we could explain what we had to do to stop inflation better that way than simply by saying that we've got to raise interest rates. It was also true that we had no other good benchmark for how much to raise interest rates in the midst of a volatile inflationary situation.

At least as important was the idea to discipline ourselves. People in the Federal Reserve don't like to raise interest rates. So the danger is you're always too little too late. I think that would apply to the current situation. So, when inflation really had the upper hand, it was, I think, very important to put something out there so you could discipline yourself. For that kind of a commitment, you've got to know what's at stake, and it does make some broad sense if you have that much inflation.

Mehrling: You say you had already been thinking about this idea of practical monetarism before you came to the Board. There were others, staff in various places around the Federal Reserve system, who had also been thinking along these lines, weren't there?

Volcker: Some version of it. The Federal Reserve Bank of St. Louis was always promoting a strictly monetarist line. It wasn't exactly the fount of my wisdom, but there was a lot of frustration in the Federal Reserve and there had been some talk about operational changes along these lines. There had actually been a study of it before I became chairman. You're right, there was a lot of restiveness in the Federal Reserve and a lot of very general talk about doing something, but nothing had ever come close to being operational.

Mehrling: I'm interested in the role of the staff in the 1979 shift in operating policy. What role did they play?

Volcker: The Federal Reserve had a very good staff, a very professional staff. But they were professional enough so that by and large they were very reluctant to speak their mind about policy. Sometimes they would get very uncomfortable when, once in a while, I'd have one of them up and ask, "What do you think we ought to do?" The basic answer you'd get was, "That's your job." In my experience, they were always very reluctant to go beyond analysis of the alternatives.

Now in this case very few staff people knew about it. There were two or three that did. The principal staff member involved was Steve Axilrod, and I think he was sympathetic. He seemed to share the anxiety for a new approach. I don't think the staff in general were sympathetic. They were not monetarist, traditionally, and this to some degree sounded too monetarist for them, I'm sure. But there was all this background of frustration—staff, as well as others that may not have liked the idea of what was viewed as a monetarist approach—but there was so much frustration that people were ready for a change. There is no doubt about that.

What really propelled me to make the change was when we raised the discount rate for the second time, when I was first down there. The vote was 4-3. I thought it was a reasonably strong move and we'd get a favorable reaction in the market, but we didn't. The response was, "Well, gee, the Federal Reserve is behind the curve anyway, the vote was 4-3, and that's the last increase of the discount rate we'll see." So the market reacted badly, which surprised me. I guess I was a little naive. I remember this very clearly. I didn't bend over backwards to try to twist the arms of the three people who voted the other way. I knew I had four votes. If we had to increase the discount rate again, we'd have another 4-3 vote. But that's not the way the market read it. Then I realized that we had this credibility problem worse than I thought. That got me off and really thinking operationally about the other approach. But when it was sprung on them, everybody was very much in favor, even those who were voting against the increases in interest rates.

Mehrling: You mean the Board.

Volcker: The Board and the Open Market Committee. The Board was more surprising. It got me a little worried. I don't know if they've ever published the minutes, but they should. I remember when we had that meeting and I said before the vote, "Are you sure you want to do this? I mean, this is going to be a big deal. We don't know where interest rates are going to go. Are you really on board here?" I couldn't get anybody to express any reservations.

Mehrling: Then there was this brief flirtation with credit controls.

Volcker: That was a sad story. By that time, early 1980, interest rates were about 17–18%, whatever they were. President Carter, of course, was coming up to an election year, and there wasn't much progress against inflation. The budget was issued and it was poorly received in the market, despite the fact that the Federal Reserve at that time was unambiguously tight. This is all clear in my mind, though it's not so clear when you go back and read the press. There was an enormous amount of skepticism, and the budget added to that skepticism. Carter felt all that pressure and felt he had to go back and redo the budget, which of course I thought was a good idea.

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Mehrling: To make it tighter fiscally?

Volcker: To make it tighter, yes. That was an interesting experience for me, just to see how that process worked. He insisted that I accompany his people up to the Hill, that I attend meetings where he was making all these decisions about the budget. That was kind of an eye opener to me for other reasons—the effort to balance constituent pressures and party doctrine against the need to reduce the deficit.

Anyway, there was a law that had been passed in the early 1970's to embarrass President Nixon, authorizing the president to call for credit controls. It was a two-stage thing. He could call for controls but the Federal Reserve would have to implement them. So Carter took the view that he wanted credit controls.

I didn't like the idea and the Board didn't like the idea. We discussed it. We had introduced some voluntary restraints on bank lending for speculative purposes in October. But the idea of really having more comprehensive and mandatory credit controls seemed undesirable. First of all, that was not the problem. We couldn't find any general excesses of credit. Housing credit was going down, so there was no problem with housing, which is a big credit user. The automobile industry was not using too much credit either, no problem. But President Carter wanted to do something, I think to demonstrate to the American people that we had a serious problem that would require restraint all around.

The Board was very reluctant, and I was reluctant. But I finally took the view that, look, we were putting the country through hell, interest rates are rising way up, the budget is being redone, and the president wants us to do this, and the president has been broadly supportive of what we are trying to do. At least, he wasn't criticizing us even though he had a lot of provocation. If he wants to do this, and he is bound and determined to announce it, then we in the Fed can hardly say we are going to refuse to implement the controls. Whether that judgment was right or wrong, I don't know, but I said to the Board, "Let us do as little as we possibly can, consistent with the request or demand that we have some credit controls." So we developed a scheme: We would exempt housing credit, we would exempt automobile credit, we would exempt home repair credit, and the only thing we would cover on the consumer side were credit cards and what in those days was nonsecured installment credit. Neither of those were very big in the general scheme of things. We said, we will put on a special reserve requirement for increases above the present level of outstandings, so it was a marginal reserve requirement on all lenders. We were trying to mimic the market as best we could, in effect raising the cost of some limited forms of consumer credit.

Mehrling: It shouldn't have done anything.

Volcker: It shouldn't have done anything, logically. We didn't want it to do very much. We wanted to make a gesture. So we put them on one day, with a big White House announcement by the President, and the economy collapses the next day. I never saw anything like it in my life! Of course, it took a while to sort this out, but to the very day, to the very week, there was a sharp reaction. Suddenly the stuff that was covered, like I guess automobile trailers or mobile homes, sales went to

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zero the next week. People were tearing up their credit cards, and sending them in to the White House. "Mr. President we want to be patriotic." Consumption just collapsed for a couple of months.

And the money supply—because people were taking their cash balances and repaying their credit cards—the money supply went down like a rock. And so all the liberal economists, as well as the monetarists, began to say, "You say you're following the money supply, you've got to ease." We were kind of stuck. "We stayed with you when you were restraining the growth of the money supply, and now the money supply is down 6% in a month,"—or whatever it was, maybe it wasn't that much but it was very sharp—"you've got to ease."

The economy, after resisting months of rising interest rates, seemed to have fallen off a cliff and so we eased. And we eased more than I would have liked, but we were trying to follow the money supply. After 3 or 4 months of this, when the extent of the downturn became clear, we took the credit controls off. We took them off the first time we had an excuse. As soon as we got them on, we wanted to get them off. Businesses selling to consumers were up in arms, going up to the White House. Department stores particularly were worried about these credit controls. What they were worried about was the credit cards, and what would happen to outstanding credit with the usual seasonal increase in November and December. That's when they have their big sales, that's when credit card outstandings go up, and the fear was we were going to discourage Christmas shopping. It hadn't occurred to me. I had no idea when we put them on that they were still going to be in force 6 or 8 months from then. Of course, you couldn't announce that they weren't going to be on in 6 or 8 months, but that was my whole mental attitude. But what they were worried about was not what was happening currently, because credit card outstandings were going down anyway for seasonal reasons. They were worried about what was going to happen in 6 months.

Mehrling: It sounds like a lesson in expectations.

Volcker: Exactly! I mean it was a big lesson, again if you needed any reinforcement, about how that kind of direct intervention can really have unexpected expectational consequences. Anyway, we took the controls off as soon as we could, and of course interest rates had declined and money had got quite easy. The economy just took off as fast as it had gone down. Then we really got behind the eight ball. It was hard to catch up with the economic strength and continuing inflation. It was a sad experience, because we basically lost, I suppose we lost 8 months or so.

Mehrling: So it took 3 years instead of 2 years before you could really change expectations.

Volcker: Exactly. I don't blame anybody. President Carter called for controls, in part, because he thought he was being supportive, right? I suppose in the end I could have said, "Mr. Carter, I don't care what you do, we're not going to implement controls." But I didn't think that extreme confrontation was appropriate.

Mehrling: So you say you took off the credit controls more or less as soon as you could. I wonder, would you say the same about practical monetarism in terms of October 1982? Once the back of inflation was broken, and Drysdale was falling, and Penn Square, Continental, and Mexico, you took off practical monetarism?

Volcker: I don't remember all the detailed circumstances at the time, but early and mid 1982 was a tense period.

The Fed staff—there's no sense blaming the Fed staff, it wasn't only them—but they had forecast some recovery in the spring, and the money supply was running very high against our targets. With that combination, I didn't feel comfortable about easing, even though the economy was not in very good shape. In particular, the inflation rate was still high, with a lot of skepticism remaining. I remember very well—all these figures have been revised, so it might not appear in just the same way in the data now available—it was some time in July that the money supply suddenly came within our target band. The Mexican crisis was brewing. The economic recovery had not appeared. I thought, ahah, here's our chance to ease credibly. So we took the first small easing step. I don't remember whether it was July or August. Of course that was all the market needed. It got a little sniff of easing and the stock market took off, the bond market took off.

Then in October, or whenever it was, the money supply (by some measures) was increasing again rather rapidly. We had a tough explanation to make, but I thought we had come to the point that we were getting boxed in by money supply data that was, in any event, strongly distorted by regulatory changes and bank behavior. We came to the conclusion that it was not very reliable to put so much weight on the money supply any more, so we backed off that approach.

Mehrling: One consequence of defeating inflationary expectations is that the dollar took off over the next couple years and the dollar became the strongest world currency. It seems to me from the record that your next move was to try to think about the international side. Is that how you remember it?

Volcker: Well, for a while it was nice having the dollar go up. I don't remember when, it was probably in 1984 or so, but at some point it clearly became a problem. We had a question what to do about it. We could have gone out and eased policy, more than policy already was eased. I didn't want to do that, because I didn't think we had won the game yet, expectations were so fragile and all the rest. All of the difficulty was made worse because we were running up against a great big budget deficit. Obviously, if I had a choice of using restrictive fiscal policy action, that would have been helpful, but that was not in the cards. Also, we had a Treasury at that point that was ideologically supportive of a strong dollar as an indicator of policy success, and was adamantly opposed to intervention, so we really didn't have the option of trying intervention as a signal that we were concerned.

I concluded we were stuck; there was nothing much we could do. We could have eased money or intervened on our own, but I didn't want to ease money any further than it was already being eased, in the face of a remarkably fast economic rebound. And we certainly didn't want to intervene on our own if the Treasury was going to say, "We're in charge of intervention; you're doing terrible things." It wouldn't have achieved our purpose. Among other things, we would have endangered our

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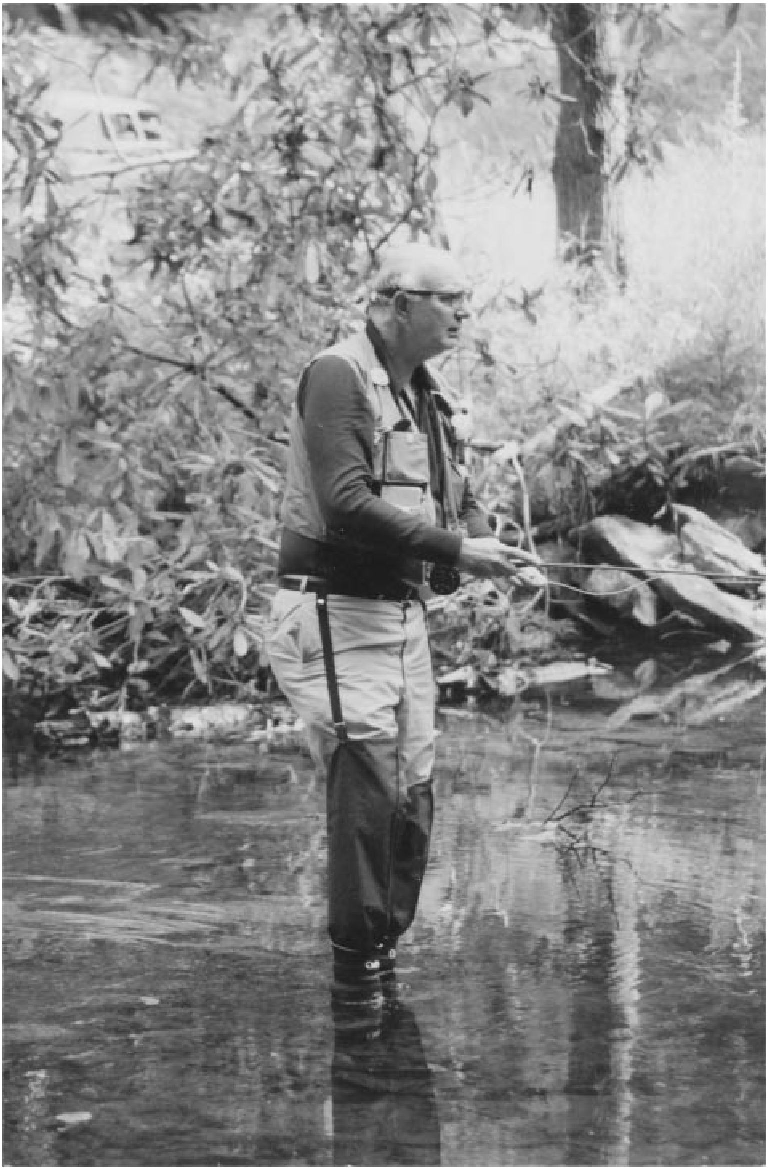

FIGURE 3. Paul Volcker, fly fishing for trout, Balsam Lake, Beaverkill Area, New York.

institutional position. So there was nothing much to do, at least until the Treasury changed its mind.

Finally, I'm told, it was Mrs. Thatcher who told President Reagan he had to do something. The pound was approaching a historic low of one dollar to one pound

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and she couldn't stand that. Mrs. Thatcher was apparently much more persuasive than anybody else, but we were heading that way anyway. The Bundesbank, which was generally reluctant to do anything to stabilize currencies, did a big intervention in the summer of 1984 when the dollar really spiked up, but the effect was temporary. It seemed to me crazy that we couldn't do that in a coordinated way.

Mehrling: One way to read this record is that the collapse of the exchange rate system in the early seventies is followed by confusion and then reestablishment of the dollar, which turns out to be the beginning of a move toward a key currency system that revolves around a couple of dominant currencies. The negotiations in the eighties at Plaza and Louvre are the tentative first baby steps in that direction. Is that how you saw it at the time? Is that how those things came about? Is that the way those negotiations took place?

Volcker: Well, the Plaza was basically a Treasury-inspired operation, which I was not terribly keen about. By that point, I thought the dollar was going down anyway, and the new Baker Treasury had already taken a more flexible attitude toward intervention. Given my history with an excessively weak dollar and inflation and all the rest, I didn't think that we had to hit the dollar on the way down for fear that it would get out of control. We had long debates about that and, in the end, the planning for the Plaza Agreement reflected much of my concern. But that was a straight get-the-dollar-down operation.

The Louvre was, in a sense, more interesting. Both Secretary Baker and his deputy, Dick Darman, had become intrigued by the idea of target zones, target ranges, or something of that sort, and I was very encouraged by this. It seemed a reasonable approach if it started with the dollar at a reasonable level. There had been a long period when Baker would go up to the Hill to testify that the dollar should be lower, and the next day I would testify that I liked a reasonably strong dollar. On balance, the contrasting statements came out not too badly, but it seemed kind of stupid at the time.

Anyway, for whatever reason, the Secretary became intellectually intrigued by the target zones, and there was pressure from Japan and Europe that didn't want to see the dollar, from their perspective, too weak. He decided that, in practice, there were things to be gained by stabilizing currencies, and so, we had the Louvre Agreement, which I was much more in sympathy with than the Plaza, not so much in the technical details but the general philosophy. Technically, the agreed ranges seemed to me too narrow, and there was no clear agreement about how to support them. It's one thing setting ranges, but in the end you've got to worry about who is going to act if the ranges are threatened, and how. If you need to change monetary policy, which side and how much? There was not sufficient attention to the fact that monetary policy was even a relevant consideration.

Mehrling: Let's move now from the past to the future. If I understand right, you expect 25 years from now that there will be a single currency in the Western Hemisphere, and 50 years from now there will be a single currency in the world. Is that right?

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Volcker: Yes, I say that now all the time. I don't mean to be taken absolutely literally, but in fact, the prospect of decidedly fewer currencies is a little more serious than I thought even a year ago. Things are happening. I think *de facto* all this e-commerce stuff, all the information revolution around it, is an important contributing factor. You're not going to communicate around the world so instantaneously, buy and sell on the Internet internationally and efficiently, and be faced with all these currencies at floating rates moving with a high degree of volatility. It's just illogical.

The European experiment with the euro I think will help demonstrate that. I think it will be successful. Back in 1989 or so, I gave the first Arthur Burns Memorial lecture in Frankfurt and I said, "You're going to be on the way to a European currency. That's a good thing and it's going to happen before the end of the century." That was not very popular doctrine in Frankfurt at the time, but it did happen and before the end of the century. It's one forecast I got right, so I remember it! So now I think the integration of the world economy pushes us further in that direction.

And second, every generation of economists has a tendency to reject at least part of what the previous generation thought. In the 1960's and 1970's, economic doctrine turned toward floating and against the Bretton Woods system of parities. It was embedded in the textbooks. But the floating system has been much more volatile than the models suggested. Now, we just begin to get a little feeling that the new generation of economists feel that floating models don't fit and policy went off the deep end. The logic of world currency, which would have seemed a wild idea 50 years ago, can at least be discussed. So, I think intellectually the ground is beginning to shift a little bit.

I used to say we'd have a world currency before the end of the next century. Then, I guess I said in 50 years. Then I would say, not in my lifetime. I'd like to say I feel well enough so that I'm beginning to think I might live to see it!

Mehrling: Well, good luck to you!

Volcker: I think it's basically a battle, that the world currency implies certain political decisions. You're going to see that happen some day, I think, even if I am realist enough to know it's beyond my lifetime. First, you're going to have a contest between regional currencies and a single currency. We're not going to have a lot of little currencies.

The whole idea that a floating currency provides great advantages for economic management—the idea often advanced for pedagogical purposes: "Wouldn't it be great if New England had their own currency, or California"—this idea is very deeply ingrained in anybody who has taken economics in the past 30 or 40 years. The central point is that you can have independent monetary policy only if you've got a floating-currency arrangement.

Obviously, that is a logical proposition. But what we are finding out is that for many countries, particularly small and open countries, a floating currency is more trouble than the independent monetary policy is worth. Many small countries have found it difficult to sustain noninflationary policies, and extreme exchange-rate

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volatility has strong economic repercussions. Stabilizing against a major currency, which is itself relatively stable in purchasing power, can help stabilize the price level in a small country. One of the big concerns about maintaining an independent monetary policy ought in this case to be moderated. Still, the United States, most of all, seems to have very little to gain from currency stability. It is already a big relatively integrated and self-sufficient area. It is top dog. It doesn't want to be constrained in a lot of directions by what goes on in the rest of the world, at least not very much.

So I think one danger is that we'll get more stability all right, by small currencies attaching to big currencies. You'll have a big euro zone and you'll have a big dollar zone, and just maybe we'll have a China RMB zone in another 25 years. But is that the kind of world we really want to cultivate, with the danger that each of the areas will become inward, and all that comes with that? To assure stability and cooperation between the areas, we will need to think in terms of some truly international standard, the role that gold used to play at the beginning of the twentieth century. Without gold or a substitute gold, you'll have to have a world central bank of some sort, which I'm not quite ready to visualize.

Mehrling: So one of the obstacles to achieving this goal is the parochial interest of the regions. Another obstacle, which is a theme in your work, is the parochial interest of the private sector, of the financiers who are benefiting from volatility?

Volcker: And the ideological trap of the economists, the intellectuals. [Laughs.]

Mehrling: Tell me what you mean by that.

Volcker: Well, you know, this whole generation of economists has been brought up on the idea that floating exchange rates are the answer to the need to reconcile national monetary autonomy with international economic integration. There is this wonderful vision of floating exchange rates. Read all of Milton Friedman's stuff of 30 or 40 years ago. He says floating rates will very nicely equilibrate for inflationary differentials, structural differences, and the business cycle. If there is a little differential shock, you'll have nice orderly adjustment of the exchange rate.

In practice, I don't think we've seen any of those orderly adjustments.

Mehrling: You're saying it doesn't happen. Now, in terms of bringing the private sector along?

Volcker: I think that financial deregulation has been another big strand of what I've been concerned about. We are dealing with a situation in which markets have become much more fluid, and there is much less control by the authorities, whether it is the Federal Reserve or somebody else. There is a lot more volatility and there are more financial crises. After the extreme crisis of the thirties, we went without a financial crisis until the middle of the seventies. In the United States, we went for 40 years without a financial crisis worth recalling. When I was in the Treasury in the sixties, Wright Patman, an extreme populist from Texas and chairman of the House Banking Committee, made a speech complaining that we had too few bank failures and too little risk taking. Well, we have fixed that problem!

How we get the advantages of an open competitive flexible financial system and deal with its proclivity toward volatility and crisis has been an unsolved problem, one that has preoccupied me. I'll tell you the Federal Reserve paid a lot more attention to banking regulation when I was there than it had before. Maybe I didn't do a good enough job, but the problem is chronic.

Mehrling: You mean supervision of individual institutions?

Volcker: Both individual institutions and the system. Really, I'm going to get a little self-serving, but I worked hard to get the capital standards of U.S. banks right. Then, with the help of the Bank of England, we set the framework for the Basle Accord capital requirements. There was a lot of resistance to it, and a feeling that international agreement was impossible. They are not perfect, and they're arbitrary, and they need to be changed, and so forth. But I think they are better than nothing. Because you are going to have to be arbitrary in this area. There are no sophisticated capital requirements sustainable for international application.

I'm very skeptical of the effort of the banks to develop so-called "modern" risk management approaches based on some theoretical modeling by mathematicians who never saw a financial market. All of this is summed up in the "value at risk" concept, which I think is borrowed from statistical and mathematical theory. The whole concept rests on the idea of normal distribution curves, but there ain't no normal distribution when it comes to financial crises, I think. They tend to run to extremes. The banks want to run a risk management system based upon the idea that we have a normal distribution of outcomes but, as has been demonstrated by the Asian and the LTCM crises, there are lots of problems there.

One of my hobbyhorses, which you haven't yet mentioned, has been the value in separating, I used to say banking and commerce, now I have to say finance and commerce. From a conflict-of-interest standpoint, from a systemic standpoint of minimizing the risk of contagious crises, from the governance standpoint, the idea of a banking system that is not beholden to industrial firms is attractive. It's getting harder and harder to find the line between them, I have to confess.

Mehrling: . . . in this market where firms can issue their own scrip.

Volcker: Both banks and commercial companies can do things with modern technology that they couldn't do before.

Mehrling: So, if I can sum up, one of the themes that emerges from your work is that markets don't manage themselves. There is a need for some, not so much a watchdog as a coordinator, or something to give direction to the system. By itself, the system can wander off in some strange direction.

Volcker: I guess that's fair. Put some limits on it at some point.

Mehrling: And that shows up in this idea about the exchange rate, trying to give some direction for market expectations because otherwise they fly all over the place?

Volcker: No question. I think that the market has no sense of what a sustainable equilibrium is now, but I don't think it's beyond imagination that it could be given a sense of a reasonable equilibrium, because there is enough to economic theorizing that there is some equilibrium out there. And it's better to stay reasonably close to it than to wander way away from it.

Mehrling: So markets don't manage themselves, and also bankers don't manage themselves given the greed, fear, and hubris combination.

Volcker: This is true. Also bureaucrats left unchecked probably don't manage themselves either.

Mehrling: Okay, also bureaucrats. And yet, with this anti-laissez faire attitude, you are also very pro-market. I'm interested in this combination.

Volcker: I would argue, and we don't have time to develop all this philosophy, that there is a role for supervision and a role for some sense of giving the market a broad sense of direction. But you can't get into the details of the markets, you can't attempt to manage it in a bureaucratic way, because it just doesn't work. It's a natural central banking attitude. Typically, central bankers like to work through indirect instruments. That's the habit, that's the way they think.

Go back to the interest equalization tax. I don't recall exactly how that arose, but the reason it was so attractive to Bob Roosa, the Undersecretary of the Treasury at the time, was the concept that this was a market-oriented thing. We weren't going to dictate particular controls, we weren't going to have exchange controls. We were going to mimic the market as best we could do it by the application of a broad tax on the export of portfolio capital. Now it turned out there was a certain implication that developed from the interest equalization tax almost immediately.

Mehrling: Arbitrage?

Volcker: Well, people did say, and it was true, that you've got to do a lot of detailed controls to avoid the arbitrage. But they also said, "Look, if the United States government thinks they don't like this capital export, and they are going to tax it, then I am not going to borrow in the United States even if I can afford to pay the tax. It's unsocial, it's unpatriotic." So it was a little bit like those other credit controls in 1980. A tax doesn't really mimic the market. It had unanticipated expectations and market effects. In fact, you know, I had to learn that lesson twice. The interest equalization tax, while it tried to mimic the market, it really didn't. What we tried to do with the credit controls in the eighties was the same. We tried to mimic the market, and we got a different kind of reaction.

Mehrling: I want to finish here by talking about the issue of the independence of the Fed. I know that you had fights about this when you were at the Fed, and a lot of it was about maintaining independence from the government. I wonder if you would accept the idea that what this is really about is about having autonomy to take the long-term interest and the general interest, instead of the particular interest of the moment, or the particular interest of the group in power at the moment. Is this independence more than just keeping government from financing itself by printing money?

Volcker: Oh, I think it's more than that. The traditional root of this concern about independence is that the executive would use the money creation power to finance itself, but I think it is a general feeling that the money creation process, even if not directly financing government, peculiarly lends itself to abuse for short-term political purposes and the consequences are longer term. I don't want to say you can't trust the political process, because in some ways I trust the political process to delegate that authority to the Federal Reserve, to the central bank. It does have something to do with taking the longer-term view, sure, and not being corrupted, if that's the right word, by very particular political pressures.

It's a grand question of money creation but also, to the extent the central bank has regulatory responsibility, banking regulation in particular is susceptible to being politicized. I think it doesn't work very well when it's politicized as we see in some countries around the world today. The Federal Reserve does pretty well at avoiding that kind of political influence to the point that I almost never had any pressure from a congressman or senator to do something for a leading constituent, which is very unusual.

I do have some kind of a grandiose view, not quite exactly what you say, that we need some public institutions that have integrity and are recognized to have integrity. People can respect them for their professionalism and continuity and so forth. There is a certain scarcity of that in the United States, as well as other countries, today. I think it's a national asset and that puts a very heavy responsibility on those institutions to behave in a way that deserves independence. It means they have to be operated with a special degree of competence, professionalism, and particularly integrity.

It's an extremely damaging thing in itself for a central bank to get caught up in politics and corruption. The central bank of Russia is pretty well destroyed by accusations, rightly or wrongly, that they are corrupt in the most egregious sense. As a result, I think Russia has lost an asset, an important institutional asset. They will need to rebuild, and it takes time. At the same time, you have to build in some accountability. But how do you get that balance of independence and accountability? It's not so easy.

Mehrling: Good place to end. Thank you.

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