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Interview of Frank H. Schott

Conducted by Robert L. Hetzel

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Frank H. Schott: But I was an Oberlin College undergraduate of the class of '49, and majored in economics. And then I went to Princeton University to get an MA in 1951 and a PhD in 1957—in economics. And then I got my further education at the Federal Reserve Bank of New York.

Robert L. Hetzel: When did you start at the Federal Reserve Bank of New York?

Frank H. Schott: In 1951.

Robert L. Hetzel: So you were at the New York Fed for a while, and then you went back to—?

Frank H. Schott: No. I worked throughout that period at the Federal Reserve Bank of New York—writing my thesis while I was working. And that is described in my memoirs, which I've offered to send you. And you can certainly make a copy of those relevant pages in the memoirs.

Robert L. Hetzel: Okay. Let's talk for a while now, but I expect I'll have more questions after I've read your memoirs. What date—this is actually important because the Korean War broke out in June of 1950 and the Accord was signed in March of 1951—so when did you start work at the New York Fed? What month? Do you remember?

Frank H. Schott: Yes. I think it was July 15, 1951.

Robert L. Hetzel: And when you read what Ralph Leach and I wrote, we emphasized the fact that the Accord gave the Fed power to move interest rates, but the issue of where the locus of power was going to be within the Federal Reserve System wasn't settled. And Sproul thought that the New York Fed should again be the preeminent center within the Federal Reserve System because that's where open market operations were conducted. And that's where the money market was. And Sproul and Roosa and the other people in the New

York Fed thought that you needed to follow the psychology of the markets. And you couldn't do that unless you were right there where the markets were.

Of course, William McChesney Martin had a very different idea. He believed that the locus of power within the Federal Reserve System should be in Washington, supported by the regional bank presidents and a federal system that reached throughout the United States. And that if you were going to have that kind of a system, then you couldn't follow the market psychology in a close way; you would just transact in Treasury Bills and let the rest of the term structure be determined, kind of, by the market. And he was supported by a young staff of people including Ralph Leach and a number of others—Dick Youngdahl and so on.

Did you feel like you became aware of those conflicts and tensions right after you went to the New York Fed?

Frank H. Schott: Just barely. You have to remember that I was a junior person and I worked on the foreign side of the thing. I worked on Western Europe and then on Latin America. I was—it took me...I would say, perhaps the better part of a decade to become an influential person at the New York Fed. I was a small cog in the machinery.

However, yes, I became aware of the conflicts between the Board and the Bank because the moment somebody made a phone call to the board, the supervisor would ask what it was about and what was discussed—that it became—there was a great deal of suspicion. And I sensed that vaguely. And it gradually came to me that it was a power struggle between the New York Fed and the Board.

I have to admit that almost from the beginning it struck me as being much too personal. It seemed to me that Federal Reserve policy should be one thing, and that the people concerned should agree on what to do. It just struck me as unseemly because the main thing I got from the New York Fed was how proper everything was. It was very hierarchic, very proper, very structured...very correct. And this, sort of, a personal messing around with Washington struck me as being out of character—unseemly. Strange, isn't it?

[00:05:15]

Robert L. Hetzel: The Board sent their young people like Ralph Leach to the New York Fed to observe. And the New York people—the New York traders—they resented that very much...having the Board people standing over their shoulder making sure...The Board people wanted to intervene all along the term structure and buy and sell long-term treasuries. And—I'm sorry, the New York people did.

And the Board people were there to make sure they didn't do it. So there was a lot of, kind of, feeling like, "Well," you know, "you're here and sort of looking over my shoulder and we don't need that sort of—" you know, "supervision. You don't trust us..." and so there was tension there.

Frank H. Schott: Yes. Yeah, sure. I mean, that was clear to me. But I didn't—I was looking at it from a mouse eyes point of view. Sorry. I just did not figure very much in this.

Robert L. Hetzel: Sure. Did you have friends in the domestic side that—

Frank H. Schott: Well, yes. My main friends at the Federal Reserve Bank of New York are all people whom you would find at any history of the Federal Reserve. One close friend was Peter Sternlight—a long-time manager of the Federal Open Market Account—who was moving forward in the ranks.

My good friend was Alan Holmes, who later became the author and then my co-author of the Foreign Exchange pamphlets put out by the Federal Reserve Bank of New York.

Robert L. Hetzel: Yes. I've been able to talk with Peter Sternlight a number of times, and he's still very vigorous and active—

Frank H. Schott: Correct.

Robert L. Hetzel: And that's wonderful. But unfortunately, by the time I started talking to people, Alan Holmes had already died. What can you tell me about him? Was he in the mold of people like Roosa? Or was he just primarily a trader and had that sort of outlook on the world that comes from being a trader of—all your life? And—

Frank H. Schott: Primarily he was the model Federal Reserve Bank of New York officer. He was a total—totally discreet, totally competent individual from whom Peter Sternlight surely took a lot of hints. He also was a little bit of a rags-to-riches story. Not literally, but figuratively. Because he went to a small college in Mississippi—Millsaps College—and he just sort of worked his way up. He never did get a PhD. But he was just so adaptable and so penetrating and so with-it...as a trader—yes, he would [00:08:18 unintelligible] anything in the decision that you drew—he would have been a trader. But first and foremost he was just a model Federal Reserve officer.

And he was appreciated for that because there were not many people—and you know to this day there are not many people—who can combine penetrating analytical skills, excellent communication skills—very carefully calibrated according to the audience...so you tell nothing if you don't want to tell anything and you want to tell exactly what you want to tell if it comes to somebody who should know...excellent communication skills, great analytical abilities...and that combined with self-effacement—that last phrase I'm using is perhaps the most difficult of all—self-effacement. Because somebody who has all the other abilities—the analytical ability, the communication skills, the knowledge of the markets—who is all those skills, it just seems like it's impossible to be also self-effacing.

And that was not given to all of them, you know, but, yeah, Holmes was the epitome of it. And Sternlight certainly is the same. And some others, for example—Roosa fell short because he wanted to make propaganda for himself.

Robert L. Hetzel: Who was this? I missed the name.

Frank H. Schott: Roosa. Robert B. Roosa.

[00:09:54]

Robert L. Hetzel: Well, let's talk about him because he had all these analytical qualities, and he also felt at home with intellectuals; he was at home in the Eastern Ivy League colleges. As an individual, people didn't find him, you know, overbearing...

Frank H. Schott: He was not. No, no. He was a good fellow. You will read in my memoirs that he did me a great favor. But what I mean is that eventually the need to go public and to be somebody in the public perhaps got the better of him. And he started grinding out statements and articles and so on. He was sort of milking his experience, but without the necessary time to give it the full scholarly depth.

And that—but, you know, never mind; everybody has to make a living. Among other things, the people who have worked for the Federal Reserve face problems sometimes of making some money. And that also was an issue with the Federal Reserve Bank of New York. So Roosa finally made sure that he had enough public stature to get a good job. I can't really blame him for that.

Robert L. Hetzel: He never was willing to accept the Board view on "bills only." And for that reason, a couple people have told me his—the possibility for his advancement within the Federal Reserve System was limited. He was possibly a candidate for the presidency of the New York Fed when Sproul resigned, although he was young. But with Martin's opposition, that wasn't possible.

Sproul wanted Treiber to succeed him, but Martin vetoed that. And so it was Martin who was instrumental in getting Al Hayes appointed—who was a wonderful gentleman, but he was—he didn't have the stature to challenge, kind of, Martin. So Roosa did make a choice. And, you know, that choice apparently prevented him from becoming President of the New York Fed, which would have been an obvious sort of career path for him. I assume he was the protégé of Sproul and was eventually on track for that position. Did you know anything about that?

Frank H. Schott: Well, some of this is news to me. It doesn't really surprise me. But when he took the job in the Kennedy Administration, I think that first of all he wanted to have more voice in government in policy than he had at the Federal Reserve Bank of New York. And that could be true of many people that have left the New York Fed because there's a certain amount of frustration involved in the relations with the Board. To this day, you know?

Robert L. Hetzel: Oh, of course.

Frank H. Schott: And then secondly, I think it became clear to me that Roosa needed money, and that he was using an administration job to take a leap forward in the financial world. And so, you know, nobody could blame anybody for doing that, really. They just—this is very difficult.

I have some friends like Sternlight and Peter Fousek, whom I haven't mentioned yet, who were lifetime in the Federal Reserve. And I wasn't willing to do that either. I had three children and I needed some money to pay college bills. So I can't—I didn't go for the big-time—the way Roosa did—but I can't blame anybody for finally trying to get something out of the service at the Federal Reserve. And it's very difficult to remain faithful throughout a career. At any rate, this is the sideline.

So I knew—Arthur Hayes, Charles Coombs, Robert B. Roosa, Peter Sternlight, Peter Fousek, Paul Volcker, Gerry Corrigan...all of those people are, you know, long-time associates and friends.

Robert L. Hetzel: I thought Corrigan came much later? I thought he came, oh, I don't know—1970 perhaps?

Frank H. Schott: Yes. I got to know him—no, he came earlier than that. He was something like an assistant secretary at the Federal Reserve Bank of New York. And he was a big fellow whom you couldn't miss in a room even then. And after that—when I was with the Equitable—I was at the New York Fed quite frequently and I got to know Corrigan quite well.

[00:15:16]

Robert L. Hetzel: Okay. Let's...yeah...I don't want to jump from character to character. Let's stay with Roosa. So when—this is a very interesting period. So Roosa goes to the Treasury—now, there's a transition between administrations. The Kennedy Administration takes the Bretton Woods system just as seriously as the Eisenhower Administration did. Everybody I've talked to said Kennedy did not want an international crisis with the gold standard while he was having international crises with the Russians.

But the difference was that the Kennedy Administration was much more interventionist. And so when Roosa came in, then he developed all these—I guess he called them "outer defenses" —swap lines and the Fed got involved in foreign exchange intervention...these forms of market intervention that supposedly bought you time so that you didn't have to adjust interest rates because you had, I guess, 7% unemployment when—or at least 6% unemployment—when the Kennedy Administration began. So in a way, Roosa won; the Fed abandoned the bills-only—at least in name—for Operation Twist.

Frank H. Schott: Twist.

Robert L. Hetzel: Yeah. Did you hear any stories about how Roosa convinced Dillon and then convinced Kennedy, and Kennedy convinced Martin to go with Operation Twist? I'm sure they just sat down and—

Frank H. Schott: No. That was still too high up for me. But you forgot the Exchange Stabilization Tax—this dumb thing...the tax on the foreign issue of bonds in this country...or was it the American purchase of foreign bonds...I think it was the American purchase of foreign bonds. It was a tax that Roosa proposed.

Robert L. Hetzel: It was the Interest Equalization Tax.

Frank H. Schott: Interest Equalization, yeah.

Robert L. Hetzel: And Volcker's the one who carried out the details with the Treasury.

Frank H. Schott: I know. And I told you already that Volcker was more of an interventionist than you would think from his later very macro-orientated anti-inflation policy.

But at any rate, yes, those were—and you know something? I didn't believe in any of this. I was a junior officer as we were resuming official foreign exchange operations. Things were going well during the Kennedy's because I felt that the domestic policy was backing up the proper use of the swap lines. That is, they were sold as a temporary intervention device to prevent speculation from becoming destabilizing. All of those are low deterums [00:18:35 phoenetic], as you know. Whether the speculation is destabilizing or stabilizing, you can argue until your blue in your face.

But the clear implication was that the intervention that we were undertaking was against the backdrop of taking appropriate domestic measures. The Kennedy Administration, I think, would never have stood for the kinds of deficits that occurred in later years. And the republicans—they would have resisted that strongly.

So at any rate, Roosa and Volcker were involved in developing what you call "outer defenses." And were not successful. Unsuccessful; Operation Twist didn't amount to beans. And, you know, I had the feeling right from the start that they didn't really expect it to work; they thought they were working the market psychology.

Robert L. Hetzel: Well, that was Charlie Coombs' life, which is coordinating central bank intervention to counter-market psychology.

Frank H. Schott: Yes. Hm-mm. Yes.

Robert L. Hetzel: And he thought the markets were run by psychology and the speculative attacks. And in a lot of people, that's the world they lived in at the time.

Frank H. Schott: Yes.

Robert L. Hetzel: This was before the demonstration that floating exchange rates, you know, were not destabilizing, so—

[00:19:55]

Frank H. Schott: Yes. Well—but I was totally aware right from the start that domestic policy had to backup exchange rate policy. It—I would write paper after paper in which we were telling Congress, "These measures that we have taken here are only temporary and they have to be backed up by appropriate domestic policy, and that means proper fiscal and monetary policy..." And, you know, most of the time we had to stop short of saying the budgets would be balanced and the monetary policies would be capable of imposing high interest rates. We stopped short of that. But our meaning was 100% clear.

From the day I wrote the first paper that was sent by the Treasury to the Congress about the resumption of official foreign exchange operations, it was 100% clear what we were saying. And it was—in a way, I think that Dillon certainly knew that. And Roosa certainly knew that. They could not conceive of running a domestic policy that would undermine the success of what they judged to be their defenses on the foreign exchange side. They knew that they had to have the proper backup domestically. And this all worked reasonably well, dear friend, until Vietnam.

Robert L. Hetzel: Well, that's right. But the Kennedy Administration was willing to raise interest rates because of the balance of payments problem. And in summer of 1963 there was a very carefully negotiated increase in the discount rate for foreign exchange reasons. But the change—and also the Fed was—the administration was willing to raise the ceilings on Regulation Q to make the deposits at New York banks more attractive.

Frank H. Schott: Yes. Uh-huh.

Robert L. Hetzel: And that was a difficult thing politically.

Frank H. Schott: Yes.

Robert L. Hetzel: But all that ended with the Johnson Administration because Johnson was a populist. And between Johnson and Congress, Reuss and Patman—neither the administration nor Congress was willing to tolerate an interest rate increase for balance of payments reasons. So the Fed went different—kind of took a different path.

Frank H. Schott: Well, I'm sure that you are right about that, but even before then—the interventionist kind of thing—that should have been, sort of, much—that should have been suspended in favor of market action. For example, the deposit rates were much too low even then. So the deposit—Regulation Q was already becoming too much of a constraint. It was obvious that the markets were doing a number on the Federal Reserve with the growth of the commercial paper market and all that. Not to speak of the Euro [00:23:16 phonetic] market.

So all of this was, sort of, rather obvious to me. I was already beginning to chafe under having bosses who seemed to be, like, King Canute, you know? To command the tides to move back.

Robert L. Hetzel: Well, there was a feeling at the time that the balance of payments problem was primarily structural. That is, if—when capital markets developed in Europe and there became less of a demand for raising capital in the United States that the problem would go away; it didn't require significant adjustment on the monetary side. It was a problem that would take care of itself in time. And I don't think the dollar was—the dollar may have been overvalued in the first part of the 1960s, but not by a lot. As you say, I think it was with domestic inflation in the United States that the system became untenable.

Frank H. Schott: Yes. Oh, I am sure you are right about that. I'm sure you're right about that. And it's just—but, supposing that you are right with everything that you said—then all the fiddling around would have been excessive too. I mean, if it was really a problem that was going to resolve itself sooner or later, why all this fiddling?

The Interest Equalization tax—I was glad that I'd beaten it out of Washington when Roosa came up with that one. In fact, he never tried that one out on me because I think he knew in advance that I was going to be totally resistant. I was becoming very stubborn because I was an anti-inflationist.

[00:25:01]

Frank H. Schott: And I believed that the proper role of the government was to give us growth without inflation. And I could never see a subordinating inflation to growth. And Johnson sent me just through the ceiling. So—he did because he was a liar. He never told us the cost of the Vietnam War, he deceived even—well, for Pete's sake, he deceived every Federal Reserve official. He deceived the Treasury. He wouldn't tell the Treasury how much the Defense Department was spending. So with all of that—

You know, I heard quite a bit of that later on— Otto Eckstein was a lifelong friend before he died too soon in '85, I think. And so he told me some of the things. It was really terrible. And because of that—I mean, you know, to the credit of Arthur Okun and then Roosa beaten out of Washington—Okun beaten out of the administration and Roosa beaten out of Washington. So they couldn't stand it anymore.

But it got worse and worse. And, you know, by the time Nixon took over, we didn't know how to cope with any and all of that. And then the Bretton Woods collapsed, and it was a lesser evil. But an evil it was.

Robert L. Hetzel: But there were very few people like yourself at that time; almost none. When you think about the people who could have been like that—for example Henry Wallich and Gottfried Haberler—they were a mixed bag. They remained interventionists. And until the end of the 1970s, Henry Wallich had these special programs—I think they were called tips—where you were going—

Frank H. Schott: Yes. Yes, yes, yes. Don't remind me of that. [Laughing] What a disaster that was.

Robert L. Hetzel: Yeah, it was a disaster. And the Carter people even tried it—floated it. You were going to tax wage increases above some—

Frank H. Schott: Yes.

Robert L. Hetzel: Inflationary level. And Gottfried Haberler in the—I have correspondence from him to Milton Freidman—there was a lively exchange between Freidman and Haberler in the 1950s about whether inflation was cost-push from labor unions or whether it was monetary. And again the same thing in the early '70s.

So people like that, who should have—who had seen the inflations in Germany and Austria and these countries and knew that they were monetary—in the United States, they thought it was the labor unions. And so—I mean, how do you account for that? Isn't that like Arthur Burns?

Frank H. Schott: Well, all right. They all...were frustrated over the inability or unwillingness of the Federal Reserve to take strong steps on its own. I am convinced that Wallich was frustrated by various Federal Reserve chairmen and various Federal Reserve Governors that he would have given it an honest to goodness try even before Volcker did—that that would have been his inclination.

In my memoirs, I am telling you a little bit about how this happened intellectually and personally. I'm telling you about the people who were survivors of the Nazi regime, and who were survivors of the inflation [00:28:54 unintelligible] of their parents. And that includes of course Wallich and Henry Kaufman and [00:29:00 unintelligible] and myself.

Those were the people who were—in later years—the inflation hawks. And we—our views were heavily conditioned by our background. If you read what happened to my family during the Great Inflation, than you will know why I took that jaundice [00:29:21 phonetic] point of view of inflation right from the start. I could tell you the stories that happened to me. One day, Ackley—who was then the chairman of the Council—he came to New York and he talked to a conference board. And he said, "This inflation that you are seeing now is induced by perhaps the sudden pull of aggregate demand, which has put too much of a strain because it came too sudden. But we'll adjust to it and it will—the aggregate—the supply will go correspondingly...*blah, blah, blah*..." He went on like that.

So afterwards I think I went to see him and I said, "I hope that you're right about inflation. But, you know, if the defense expenditures continue to escalate, you might see a really major inflation before aggregate supply ever can catch up."

[00:30:09]

Frank H. Schott: And he wired [00:30:11 phonetic] at me. He said, "What do you think we—do you think we are bezerk?" Those were his words. Those were his words. And now who was right? You know, it grates me to this day.

And so you know that there were some people who had a perfectly clear view of what might happen unless you took a strong stand on inflation. Now it is true that in the fears of men, particularly in a democracy, things have to go fairly wrong before the body politic really starts putting it right. You see a current illustration in the "Corporate Governance" issue. There has to be a horror story before you really start taking action. And the inflation—it may have been the same [00:31:00 unintelligible] as that, sir. It may be the same thing. That it had to happen in this country before people woke up.

Robert L. Hetzel: Well, getting back to Ackley—Ackley had the idea that government would—you could get politicians to undertake a program of aggregate demand management—raise taxes, lower taxes, and control aggregate demand. That was the Keynesian agenda. And he believed in it.

He believed that it was possible that the politicians, that Congress, that the administration, that President Johnson, that Wilbur Mills—that they would listen to people like him and that they would raise taxes when they needed to, to constrain aggregate demand. They lowered taxes in 1964 to stimulate aggregate demand. And that was going to be his legacy—that he was going to show that there was a symmetry there. That was what all the Keynesians believed—that government would behave that way.

Frank H. Schott: I think that you are right and I think that they should get credit for that. The Johnson Council of Economic Advisors should get credit because behind the closed doors they told him all about it. But what—it goes back perhaps to the fundamental question of what you do when you're faced [00:32:23 phonetic] with a basic major policy disagreement in Washington. There are not enough people who resign when such a thing occurs. Secretary of State Vance, who resigned over the attack on Iran—when the prisoners were held at the American Embassy in Teheran—he's one of the rare exceptions of a guy who actually quit because he disagreed with the policy.

Now the Johnson Council of Economic Advisors could have had a tremendous effect if they had resigned amass. That would have been a real turning point. I think that many people in Congress were ready to say that you have to pay for the war. And it wasn't done. And that—you know, sort of clinging to power and going along with what you don't believe, is perhaps the major part of Washington policy. It makes me so cynical to see that illustration over and over again.

But at any rate, it isn't—you know, this has not been an issue with the Federal Reserve in recent years. They have had their way and their way has been correct. So there hasn't been any big problem there. But there continues to be a problem in general of people who know that something is terribly wrong, have a strongly held contrary view, and simply are overruled. And then they sit back and...and then perhaps they leak it to the press, but that's about the extent of what they're willing to do. Now that's—you know, that's not really the straightforward course. The straightforward course is to beat it out of there...if you are influential enough to make a statement to that effect.

Now this is a lot to expect—I know, I know, I know. So anyways, a side comment—to reveal perhaps more than I should about where I come from. But at least it's straightforward so you know.

So Ackley—yes, sure Ackley was—he gets a lot of credit. I mean, he was by far—he was a good egg in many ways. But the story I told you illustrates that he could not conceive that no matter how much he loused it up and how much Johnson loused it up, that we could have something that would be a major inflation. He could not conceive of that. And of course was an American conceit—I mean, everybody until the late 1970s thought, "Oh, we are immune from that." And they had to be—push their nose into it to find out that the people who came from the old country that had issued the warnings were right.

[00:35:12]

Robert L. Hetzel: Okay. Let's go back to the Eisenhower Administration. Do you feel like the Eisenhower Administration responded appropriately to the out close of gold? Did they get it right under Anderson?

Frank H. Schott: Well, that was, again, a little bit before I became very conscious of policy issues. But the Bretton Woods system was being undermined by the recovery of Europe and their underlying distrust of their own strength—so that the gold under the mattress became the refuge for the French peasant again. And that of course was a serious problem for the Bretton Woods system.

It's a moot point whether this could have been renegotiated so that you would have had a mutually satisfactory arrangement of international Reserve necessities as where the economy expanded, without giving ground in the gold price. It's a terribly difficult subject.

So at any rate, I don't believe that the Eisenhower people thought that they were going to have a major dollar problem—a dollar crisis. And sort of inconceivable to them—you know, you're still mired in the mud and Asia hadn't done a thing. And so I don't believe that they took that as a major policy problem.

Actually, you know, Roosa and Kennedy were much more conscious of that as a major problem. And that's why we got back into the foreign exchange operations. The original idea, I think, was to protect the U.S. gold stock.

Robert L. Hetzel: Did you at some point become an advocate of floating exchange rates?

Frank H. Schott: Yes.

Robert L. Hetzel: When?

Frank H. Schott: Yes. It happened when I saw that I was butting my head against the wall with the Johnson people about the government deficit and the financing of the Vietnam War. Having said from the beginning that appropriate domestic policy was necessary to bolster the foreign exchange regime—that we were supposed to maintain with the [00:38:05 unintelligible] of exchange rates through those open market operations...having maintained that from the beginning, I saw that if I couldn't have it done that way, then there was no use trying to maintain the dollar. And so, yes, by the early 1970s I saw it as a lesser evil to abandon the fixed oil rate.

Robert L. Hetzel: So that came pretty close to the August 15th Camp David decision to close the gold window?

Frank H. Schott: Yes. Yes. By that time I was not unsympathetic to the Nixon Administration decision.

Robert L. Hetzel: Do you remember—and this is something which I, you know, would like to get more of a record of—through the 1960's there was still very vivid in the minds of the average, kind of, person in Washington and the average policy maker, the idea that foreign exchange rate volatility and manipulations and instability had contributed to the difficulties of the Great Depression.

And policy makers thought that the Bretton Woods system, which would prevent unilateral depreciations, would keep that monetary instability from arising again. And they associated floating exchange rates with that sort of instability—that is these competitive depreciations in the minds of the policy makers became, kind of, very much identified with the idea that, well, if the country lets its currency float, it's going to depreciate it and that will cause all kinds of problems. And so there was enormous resistance. I mean, it was almost inconceivable in the 1960s that, you know, the United States would advocate a floating exchange rate system.

[00:40:08]

Robert L. Hetzel: Do you remember some of that attitude in—?

Frank H. Schott: Oh, sure.

Robert L. Hetzel: And can you—

Frank H. Schott: Sure. And I thought that it was the proper attitude if backed up by the domestic policy; that that was the logical consequence of that. I mean, it is—in a fixed exchange rate system, domestic policy has to be addressed more, and external policy less—by definition. So I said that we would have to act domestically to back up our foreign exchange views, which were that a stable dollar was good—both for ourselves and the world.

Robert L. Hetzel: What about the attitudes of someone like Charlie Coombs? Can you—we talked about him a little bit, but what can you tell me about his relationship with the New York Fed and the Board and the Treasury? And his attitudes?

Frank H. Schott: Well, he was a pretty complex personality. But underneath it all, he was a CIA-type operator. He was a discreet spy who had the national interest of the United States—which he thought he knew exactly what it was at heart, and he was willing to do almost anything in order to achieve those objectives. He was a true operator. You know?

He wasn't—I think he was—whether he was a CIA station chief or what he was—in Greece, before he came back after...now this is somewhere in the late '40s, early '50s—and he helped contain the communists in Greece. That became a defining moment in—not necessarily...well, of course he was a strong anti-communist, but it ultimately became a defining moment in how he thought you could get things done. He was a model of discretion; good judgement and ruthlessness in the pursuit of his objectives. And he was more international policy-minded than anybody else at the Federal Reserve at the time. But he was—he also was very much aware of—that it was going to be his path to glory.

When the German foreign exchange operator— Tüngler was his name—outlined to him how you could intervene in the exchanges and that he could provide a swap line to the U.S.—so we would have DMs [00:43:10 phonetic] to operate with...because, you know, Coombs was asking, "How in the hell do I get the resources to operate? If I want to do the same thing that they do?"—with respect to the exchange rate.

First of all, he was encouraged by the Germans to try it. And secondly they were willing to provide those swap lines, plus they said, "You have the exchange stabilization fund of the Treasury." So he got the idea and he brilliantly carried that forward—that idea. Of course with the full cooperation and understanding of Robert B. Roosa.

Robert L. Hetzel: So, tell me, what was the name of the German you mentioned?

Frank H. Schott: His name was Tüngler. T-U-umlaut-N-G-L-E-R. He was the Vice President of the Bundesbank in charge of foreign exchange.

Robert L. Hetzel: And so Roosa and Coombs were close because the New York Fed connection?

Frank H. Schott: Yes. Yes. Well, they had gone up in the ranks together. Roosa was ahead of Coombs, but once Roosa went to Washington, Coombs became his counterpart. He might—in my little story, I tell you a little something...perhaps not enough—about the relationships that existed when the Treasury and the Federal Reserve were trying to cooperate in the resume foreign exchange operations. This of course is not so easy to this day, you know?

Robert L. Hetzel: Yes.

Frank H. Schott: But as it started out, Roosa, who by then was a federal government official, was asserting to supremacy of the political arm.

[00:44:57]

Frank H. Schott: And Coombs was—and Alfred Hayes and William McChesney Martin—were trying to assert the supremacy of the technical arm to carry out the technical operation. You know what I mean?

Coombs and his associates were trying to make this look like you have to be a really good foreign exchange man and know the markets in order to know what you're doing. And Roosa—and Dillon—were saying, "Buzz off. This is—you're intruding on foreign policy territory, and we know best what to do."

And plus the fact that it controlled Foreign Exchange Stabilization Fund. Yes, the Federal Reserve had to get its resources from those swap lines, you know?

Robert L. Hetzel: Well...but they—I'm going to send you an article on this that I wrote, where I go back and read the minutes and talk about the debates at the time. But ultimately, it was the Treasury that needed the Fed because the Foreign Exchange Stabilization Fund had its money tied up with loans to South American countries. And it was the ability to create dollars in limitless amounts that gave you the ability to intervene in foreign exchange markets. So that it was the Treasury that needed the Fed.

Frank H. Schott: Right. You see, this is—[chuckling] they needed each other. The Treasury certainly needed the Federal Reserve expertise. The year that I spent in Washington was really being the liaison between Roosa and Coombs. And before that, we had—Alan Holmes had that job first. And then there was another man who had that job...Merlyn Trued...and then I got it. And then after I left in '63, Merlyn Trued, who was then the assistant vice president of the New York Fed was called back—

[End of first recording]

[Beginning of second recording]

Frank H. Schott: ...That could be put out for longer terms. Those forms were supposed to be liquidated very quickly, you know?

Robert L. Hetzel: Right...

Frank H. Schott: So it was not as if—and plus the fact that at least in my time, the Federal Reserve did not really want to push the relationship to the breaking point. Nobody wanted to have another confrontation like the Accord.

Robert L. Hetzel: Hm-mm. Yup. So you've told me two somewhat different things. You said there was a rivalry and a tension between the Fed and the Treasury where—I mean, all Treasuries assert that foreign exchange intervention is—deals with foreign affairs and therefore is the province of the Treasury.

On the other hand, central banks need—they want the prestige of the central bank, and they need the ability of the central bank to create the dollars that can be used in the swap lines to borrow the foreign currencies. The Foreign Exchange Stabilization Fund didn't have that much in the way of free resources. So there's this tension.

On the other hand you told me, you know, Coombs and Roosa were very close, and so—

Frank H. Schott: Yes. They were close like brothers. You know? They'd fight like brothers. They had a common front when it came to anybody who wanted to say, "Quit that fiddling around." And then if Milton Freidman had walked in there and said, "You're all wet, just let the foreign exchange rates float," they would have immediately closed ranks. They were of one mind on that. There's no contradiction at all. But when it came to who has what rights—[chuckling] they were fighting like brothers.

And the foreign exchange consultants—the New York Fed and the Treasury—somehow I was the errand boy who went delivering messages back and forth that everybody knew was loaded. I can remember arguing with the Treasury man who sat in the same office at the Treasury—among other things—made me sit in the same office with the Treasury official who was supposed to know exactly what I was doing and who was supposed to learn enough so that they wouldn't need another consultant from the New York Fed.

[00:50:00]

So later they solved that problem by appointing a deputy assistant secretary from the New York Fed, as I mentioned to you. But in the meantime, this fellow—Paige Nelson—he was supposed to...well, not spy on me, but work with me cooperatively so that we would do exactly the same thing. So I can remember arguing with him. I'd say, "You know, the New York Fed seems to be on the point of wanting to hold the DM dollar line at this point, and I think that the Bundesbank has encouraged them to do that." So he says to me, "Well you have to tell Roosa immediately." I said, "Well, now, wait just a moment. I was told that confidentially by the operator at the New York Fed, and we are not really sure that the Germans mean what they say; they have to clarify to some—" "You have to tell him immediately."

So this is the kind of atmosphere that prevailed. That—you know, at my level. But at their level, well, they would very politely say who should call that or the foreign Treasury man or the foreign Federal Bank official and they would—you know, they would try to avoid direct confrontations.

Robert L. Hetzel: Did you have any contact with Paul Volcker at this time? At the Treasury?

Frank H. Schott: Now the timing of this is a little bit off. I think that Volcker was at Chase at that time.

Robert L. Hetzel: He was at Chase—okay.

Frank H. Schott: Yes. He came to the Treasury with the Nixon people. I think during the Kennedy time—I think Volcker was either at the New York Fed or at the Chase.

Robert L. Hetzel: Well he was at Chase in the late '50s, and then he went to the Treasury with the Kennedy people and he stayed until fall of 1965. And then he went to Chase. And then he came back in with the Kennedy people.

Frank H. Schott: Kennedy? Nixon.

Robert L. Hetzel: I'm sorry, yeah—the Nixon people.

Frank H. Schott: No. That...no. Again then, if he was already there, I had no contact with him. He was on the domestic side probably.

Robert L. Hetzel: Yes, in domestic debt management. But apparently he was involved in the international too, because he wrote the regulations for the Interest Equalization Tax.

Frank H. Schott: Oh, I see. No, I didn't have any contact with him at the Treasury. I was back at the New York Fed by that time. I was at the Treasury only a year.

And, yes, that's right—now it comes back to me. Yes, he was at the Treasury, but I got out of the Federal Reserve in '66 with the Equitable. And I'm telling you of what I was doing at the New York Fed after I got back from the Treasury too, in my memoirs. You'll see that. But—

Robert L. Hetzel: Well, I'm wondering if we shouldn't—

[End of second recording]