



FEDERAL RESERVE BANK *of* ST. LOUIS
CENTRAL to AMERICA'S ECONOMY™

P.O. Box 442
St. Louis, MO 63166
www.stlouisfed.org

Interview of Robert Solomon

Conducted by Robert L. Hetzel

July 13, 1994

Robert L. Hetzel: And which section did you go into?

Robert Solomon: I went into what was called the International Section. There wasn't an International Division at that time. I started in the International Section working on the general international financial problems. The Marshall Plan was just getting started. Let's see. Well, I don't remember precisely what I worked on those first days, I'm afraid, but it wasn't a country area job. Then I moved into the European Section, I guess, when the Marshall Plan really got going and worked on France, Germany and Holland during the Marshall Plan. I wrote my dissertation on the post-war business cycle in Belgium, actually. It was the first European cyclical movement after World War II.

Robert L. Hetzel: So you were always in international.

Robert Solomon: Then in '55 I moved over to the Domestic Division and worked first in the backing section. Then I became head of the Capital Market Section. Then I became General Advisor in a division working on a variety of problems that were of interest to the Director of the Division. Then as I said, I went over and spent a year at the Council and then came back shortly after and became advisor to the Board. There was a big shakeup in the Board. The older generation retired. Names that may be familiar to you are Ralph Young.

Robert L. Hetzel: Ralph Young didn't retire until what? '62? Or...

Robert Solomon: I don't remember when he retired as head of the...

Robert L. Hetzel: He was Secretary of the FOMC, right? So he didn't...

Robert Solomon: He's also head of the second director of the International Division. The first one was Robert Martin who left, I don't know [unintelligible -- 00:02:13] or something.

Robert L. Hetzel: Right.

Robert Solomon: Ralph took over that and I succeeded him as Head of the Division after Robert and I was already Advisor to the Board so I had both titles.

Robert L. Hetzel: What can you tell me about Ralph Young and his relationship with Chairman Martin? They must have worked very closely together.

Robert Solomon: Yeah, I don't know much about that relationship. Ralph was basically--I wouldn't want to be quoted on anything personal about anybody I say to you.

Robert L. Hetzel: Oh, absolutely. I've worked for the Fed since '75, and I understand.

Robert Solomon: Ralph is just a marvelous organizer. I don't think he was a great economist, but he's a research organizer. That was his forte, and he did that extremely well and he had an eye for people with talent and knew how to motivate and make the most of them in a nice way.

Robert L. Hetzel: Well, I think I could quote that. Those are complimentary things.

Robert Solomon: Okay. Sure.

Robert L. Hetzel: When you started at the Fed, were you aware of the debates that were going on between the Fed and the Treasury. You know, the things that later became the Accord?

Robert Solomon: Oh, sure. Of course. I was very junior but, yeah, I was aware of it.

Robert L. Hetzel: Sproul and Eccles were the two driving forces within the Fed?

Robert Solomon: I guess in the Fed and Bill Martin over at the Treasury kind of--what's the word?

Robert L. Hetzel: Facilitated.

Robert Solomon: Facilitated the agreement, which in turn led to his appointment as Chairman, of course.

Robert L. Hetzel: Did you have any contact with Winfield Riefler?

Robert Solomon: Yes, a lot of contact with Win Riefler. He was still there and I was junior, but he kind of like me and I used to sit at lunch with him and Woody Thomas often in the cafeteria.

Robert L. Hetzel: Would they talk at all about the 20s and the 30s and what they thought had caused the Depression? Do you remember conversations like that?

Robert Solomon: I don't remember that. What I mainly remember is that both Win and Woody were very obviously Pre-Keynesian.

Robert L. Hetzel: Sure.

Robert Solomon: I don't mean just in terms of their age, but in terms of their thinking. They hadn't absorbed. I can still remember trying to explain to Woody Thomas how it is that we have to expect a larger budget deficit in a period of recession. This was '59-'60. These simple relationships that we take for granted in income accounting among the major components, they just didn't think in those terms. Am I making myself clear?

{00:05:05}

Robert L. Hetzel: Yeah. I'm just thinking that I want to come back to that in a minute because I'm interested. I mean, that was Martin's view, too. He was obviously Pre-Keynesian.

Robert Solomon: Martin was more--he understood it better I think. In his own way, though, he was maybe less formally trained as an economist than they were. You didn't get that same feeling about Bill Martin, that he was from another age as I did. He was more somehow with it. Well, for one thing, Bill Martin--interesting sideline on Bill Martin. When he was Chairman of the New York Stock Exchange in his mid-30s. He must have been born around the beginning of the century. He took courses in Economics at Columbia. I doubt that the professors realized that they had the Chairman of the New York Stock Exchange in their classes, but he did.

Robert L. Hetzel: That's interesting. Well, we could certainly find out who taught him. There are people around from that time. Anna Schwartz would probably know or Art [unintelligible -- 00:06:20]. People like that.

Robert Solomon: Bill's around. He's not too well, but he's around.

Robert L. Hetzel: Do you think he'd be willing to talk to somebody like me? A couple of people have said, "Well, why don't you call Bill Martin?" And I felt kind of dumbstruck.

Robert Solomon: If you'd like to go and see him, he's confined to a wheelchair. But as far as I know, he's pretty coherent and he's a very nice man.

Robert L. Hetzel: Do you know who would have an address for him where I could write him a letter?

Robert Solomon: I'll find it for you.

Robert L. Hetzel: Oh, okay. Sure. Well, I'd certainly love to write him a letter. And if he's be willing to see me, I'd go up to Washington in a flash.

Robert Solomon: Well, we talk. I'll find it right here. I've been to the house. I just don't know the exact address. But go ahead.

Robert L. Hetzel: Okay. Well, let's go through this early period just a little bit more before we come back to Martin. What were your impressions of McCabe? What people say-- and I don't know whether this is right or not.

Robert Solomon: I had virtually no contact with him.

Robert L. Hetzel: Okay.

Robert Solomon: I repeat, I was pretty junior. I didn't meet with the Chairman of the Board and I didn't go to board meetings at that stage.

Robert L. Hetzel: When was the first board meeting you went to? Do you remember?

Robert Solomon: Oh, gosh. You've got me. I mean, I could have attended a couple way back. But in any sort of importance--even semi-important way was probably around 1960. I became Chief of the Capital Market Section. I was the group that would brief the board. I did that every Monday morning.

Robert L. Hetzel: Did Chuck Bartis succeed you in that position?.

Robert Solomon: Yes, exactly.

Robert L. Hetzel: The Fed, you know, after the accord, really had no mandate. Congress from that point on was willing to tell the Fed what it didn't like, but it never told the Fed what it wanted the Fed to do.

Robert Solomon: The Employment Act of '46. That was the only sort of general guidance.

Robert L. Hetzel: But that was a very general--I mean, people interpreted that totally differently. Truman's council on the one hand and Eisenhower's council on the other were enormously different. But Martin's idea was you just kind of use a common sense approach to make interest rates. Interest rates should make sense in terms of what the economy's doing, basically?

Robert Solomon: Lean against the wind. I don't know how coherent. You know, that was the days before the Fed moved to the monetary average that we always--the general approach was interest rates and somehow the supply of credit. I think that's the way people thought in terms of what the Fed was trying to influence.

Robert L. Hetzel: Did you have any sense of how Martin was affected by the Depression? My impression in reading minutes and that kind of thing is that he felt that in the

1920s inflation and speculation had caused what became the Great Depression and that the primary role of the Fed was to prevent speculative activity and keep inflation down. Does that sound right to you?

Robert Solomon: Well, it sounds right but whether that's what he thought about the Great Depression, I don't know. The primary role of the Fed--yeah, it's to keep inflation down but also there's some concern there about real activity, certainly in the recessions.

{00:10:10}

There was two recessions in the 50s, '53-'54 and again in '57-'58. The Fed was pretty active in trying to overcome those recessions.

Robert L. Hetzel: But my understanding is that Martin later came to believe that the Fed had been too expansionary after the '53-'54 recession, that that had contributed to subsequent inflation, and that was one reason the Fed was so restrictive in '58. And especially coming out of the '58 recession, the reason why the Fed pushed rates up so much. Does that sound...

Robert Solomon: I don't know. I don't have a view on that, I'm afraid. I do remember that that recovery was very rapid in '58 so that even if he hadn't had that historical view, he might have felt the Fed had to move fast because the economy was going up so quickly. That's my recollection. I haven't looked at the numbers.

Robert L. Hetzel: That sounds right. It was a short, sharp recession.

Robert Solomon: Right.

Robert L. Hetzel: I suppose the steel strike made the trough sharper than it...

Robert Solomon: I think we were all surprised at the vigor--the speed of that recovery, as I recall now.

Robert L. Hetzel: Well, Martin and Secretary of Treasury Anderson lined up against tax cut at that time and on the other side you had--well, Burns was out of Washington, but he and some of the council like McCracken favored a tax cut, but ultimately Eisenhower weighed in on...

Robert Solomon: Was that in '58?

Robert L. Hetzel: Yeah.

Robert Solomon: Yeah, I don't remember that, I'm afraid.

Robert L. Hetzel: You don't? Okay. Well, let's go to early '60 and let me ask you a couple of questions about...

Robert Solomon: Just take a moment. I'll give you Bill Martin's street address.

Robert L. Hetzel: Thank you.

Robert Solomon: And then I'll look up his zip code for you.

Robert L. Hetzel: Okay.

Robert Solomon: William Martin, 2861 Woodland Drive, Northwest and it's Washington, D.C. and I'll come up with the zip code before we finish here.

Robert L. Hetzel: Okay. Great. After Kennedy was elected, particularly in 1961 there was concern over the balance of payments. I guess it had been about a billion a year since '58-'59 and it grew to about \$3 billion a year. And there was a general agreement in the Administration that it would be dealt with through non-monetary means because there was a concern about the strength of the recovery, and I guess it's fair to say they were always haunted by the idea that they'd have another recession in '60 that would just come before the recovery had been completed. So out of that, the Treasury became interested in the sterilized foreign exchange intervention. The Treasury had its own exchange stabilization fund, but in '61 it was unwilling to go to Congress to get the authorization increased so it could intervene. Instead, it went to the Fed. Why was the Treasury so unwilling to go to Congress for an increase in authorization for the exchange stabilization fund?

Robert Solomon: I do not know and I don't know who you can ask. Bob Roosa's no longer around. Paul Volcker who became his--I don't remember if he was a deputy. No, he wasn't a deputy but he worked with Bob at the Treasury. Paul might know.

Robert L. Hetzel: Okay.

Robert Solomon: He's accessible. I can even give you a phone number for him.

Robert L. Hetzel: He is accessible? I would...

Robert Solomon: Paul?

Robert L. Hetzel: Yeah, I've heard that but it's like I just can't quite believe it. How could somebody like that...

Robert Solomon: Well, he's a nice--I've known Paul...

Robert L. Hetzel: Well, yeah, that's what everybody says, but it just seems so...

Robert Solomon: He's a very decent man. If you tell him what you're interested in, he'll try to help you.

Robert L. Hetzel: Yeah, okay. That's what everybody says. I guess I should believe it.

Robert Solomon: Well, believe it. He is one of the most--considering how eminent he is, he's absolutely unpretentious. [unintelligible -- 00:14:32] himself and it never changed. I've known him since 1962 or something like that. That's 32 years.

Robert L. Hetzel: Do you remember anything of the debates within the FOMC at the time over whether to get involved in sterilized foreign exchange?

Robert Solomon: No. See, I wasn't sitting in on FOMC meetings then. I don't have the recollection that there was a lot of intervention that early on. You may have the numbers to prove me wrong, but my impression is that primarily what was going on in the early 60s were these various--the stuff in my book--the various defenses that were constructed by Bob Roosa. Roosa Bonds and, of course, we did sell gold when we had it, which did mop up dollars in the same way that intervention would. But I thought the swap network and the gold pool was used. I didn't think there was a tremendous amount of intervention that early on.

Robert L. Hetzel: Well, I went back. I have read the minutes for that period because my president asked me to review it when we got involved in the Mexican swap intervention. And it's not totally clear, but it looked like what happened is that in '61 the Exchange Stabilization Fund committed itself heavily to buying marks forward because that didn't show up on its authorization. It didn't count against the limit. And after the Berlin Wall went up, it was easy to unwind that. But then later on in the Fall, they got involved in Italian lire and Swiss franc forward contracts, but they were having a lot of trouble unwinding them because those currencies didn't weaken subsequently, and they were afraid that when they had to close the contracts out by buying in the spot market, that would push them over the limit. And that's why they were so concerned that the Fed get involved and take some of those francs and marks off its books.

Robert Solomon: I'm afraid I don't know that part of it. I'm sorry.

Robert L. Hetzel: Okay. Well, I'm going to talk to Dewey Daane, too, and he may remember.

Robert Solomon: He was in Treasury. He was Bob Roosa's assistant.

Robert L. Hetzel: Assistant, so he may remember some of that, too.

Robert Solomon: He may remember. It looks as if Martin's zip code is 20007. I hope that's right. You'll catch him anyway.

Robert L. Hetzel: Well, I can look it up in a zip code book. Do you remember--do you have impressions of the FOMC and Martin's interaction with it in the 60s? My general impression is that he was the dominant person in the 50s. Many of the appointees to the FOMC--the governors, at least, were political. They weren't real strong figures, but it was a more complicated situation in the 60s. He had a group of people like Balderston and Hayes that were quite conservative, and then he had an emerging group of people like Mitchell.

Robert Solomon: Mitchell was the first.

Robert L. Hetzel: Later on Brimmer who were quite concerned about unemployment.

Robert Solomon: Right.

Robert L. Hetzel: He really had to kind of walk between those groups.

Robert Solomon: I was not attending in the 50s, but my impression is similar to yours about the committee except for Alan Sproul, who was probably the second strongest force.

Robert L. Hetzel: You mean Hayes.

Robert Solomon: Well, when did Hayes come in? I'm talking about the 50s.

Robert L. Hetzel: Yeah, I'm sorry. Oh, right. Yes.

Robert Solomon: I'm saying that, though I was not attending in the 50s.

Robert L. Hetzel: About the 50s, yeah.

Robert Solomon: My impression is similar to yours about the nature of the committee and Martin's role in it at that time, but that's just an impression I have, not a matter of my own observation. I would have thought that Sproul probably played a major role.

Robert L. Hetzel: That I don't know so much about. I know that he and Martin tangled, especially on this thing over Bill's only--that Sproul viewed that as an infringing on the prerogative of the New York Bank to conduct open market operations, and there was a lot of acrimony over that.

Robert Solomon: Well, I was opposed to that. I mean, that was Win Riefler's 80s. I once made it. I hated to do it. Please don't use this, but I wanted to call that Capital B Bill's only policy. Hello?

Robert L. Hetzel: Yeah, I'm here. What is it? Capital B, Bill's only. Oh, I see. Oh, that's cute.

Robert Solomon: [unintelligible -- 00:19:42].

Robert L. Hetzel: Yeah, I never.

Robert Solomon: Please do not use that. I wouldn't want that used against my friend, Bill Martin.

Robert L. Hetzel: No. I mean, Martin was...

Robert Solomon: It was Riefler.

Robert L. Hetzel: Martin didn't want to convey the impression to the Treasury that we could support long-term bond prices.

{00:20:00}

Robert Solomon: That's right. That changed in the 60s.

Robert L. Hetzel: Do you feel like Martin changed in the 60s at all? That he became more concerned about the economy, as opposed to inflation? I mean, ultimately, monetary policy was more stimulative in the 60s. It was just a more difficult environment.

Robert Solomon: The early 60s inflation was low.

Robert L. Hetzel: Sure.

Robert Solomon: And the economy was in a fairly long recession. There was, I'm sure, influence to some degree by the--I'm thinking of the people in the Kennedy Administration who cultivated him. I don't know if that's the right word.

Robert L. Hetzel: I'm not sure what. It would be interesting to get...

Robert Solomon: The composition of the Committee was changing. George Mitchell was appointed fairly early in the 60s, as I recall.

Robert L. Hetzel: Right.

Robert Solomon: Anyway, Bill was not--I don't think of Bill as being an absolutely hard liner. You can name other people who are much more hard liners, both then and now, but any [unintelligible -- 00:21:35] is going to put inflation very high on his priorities list, needless to say.

Robert L. Hetzel: Do you have any recollections of 1965 and the discount rate increase?

Robert Solomon: Oh, yeah. See, that was just after three of us, Bob Palmer and Dan Brill and I were appointed to the top staff positions at the Board.

Robert L. Hetzel: Who were the other two?

Robert Solomon: Dan Brill was made head of the Division Research.

Robert L. Hetzel: And then?

Robert Solomon: Bob Palmer I think was named Secretary of the Board or maybe he was at first the second advisor from what I can remember. But anyway, all three of us moved up and we sort of replaced, in effect, Riefler, Young and Woody Thomas.

Robert L. Hetzel: Martin still had a St. Louis connection and from McDonald defense contractors in St. Louis he got early wind of the defense buildup.

Robert Solomon: Whether he got it from them or from his friend from the Pentagon. My impression was he got it from the Pentagon. But who knows? It may have been both.

Robert L. Hetzel: And he thought...

Robert Solomon: But if that's in the book, then he had early wind of the size of the defense buildup, then that's the reason why he so early started to tighten--wanted to tighten up [unintelligible -- 00:23:07] with that discount rate increase. What was it? December '65?

Robert L. Hetzel: Yeah, thought inflation came from two causes, excessive government spending and speculation in the money markets, and he was just concerned about inflation.

Robert Solomon: I think it was the first more than the second. He was concerned about the buildup of government spending. I mean, the orders are going out and they didn't show up in expenditures in the national accounts figures or even the budgetary figures. But he got wind of the orders. That's my impression. And the council people tried to hold him off. They didn't disagree that this was necessary, but they wanted to wait for awhile because there was some other action pending. This is in the book, too. I can't remember what it was. I think it's in the book. Some other action was pending, and they wanted to get that done before the Fed acted.

Robert L. Hetzel: Which book are you talking about?

Robert Solomon: My book.

Robert L. Hetzel: Your book. Yeah, right. Right. Yeah, I did read that section. They wanted the estimates of defense spending for 1967 and then the argument was they were going to put together a recommendation for fiscal and monetary policy at the same time, and they were going to do that in January of '67. And Martin went ahead and moved anyway in December.

Robert Solomon: Exactly. The budget proposal [unintelligible -- 00:24:47].

Robert L. Hetzel: But as you point out...

Robert Solomon: They wanted him to wait. I still remember getting a call from Art Okun. He was a member of the council at that time, and I remember getting a call from Art the day the Fed met on the discount rates. I remember getting a call that morning from Art.

Not that I could do anything about it, but anyway, they were very concerned about it. Not about the action but about its timing.

Robert L. Hetzel: It was fairly shortly after that the council came around and thought that the Fed was doing the right thing. But at that point, they perhaps still thought they could get some coordination with fiscal policy. Perhaps some increase in taxes or they thought maybe...

Robert Solomon: I don't know how early that started. I just don't remember. But for some time they had--the relations were pretty good. Martin used to meet with the...

Robert L. Hetzel: The quadriad.

Robert Solomon: [unintelligible -- 00:25:57] Walter Heller and Coyne

Robert L. Hetzel: Well, relations were good up until that point because the economy was doing well and inflation was low and Johnson was thinking mostly about fiscal policy and nobody was thinking much about monetary policy.

Robert Solomon: Well, things were happening. The Fed they did abandon Bills Only and started buying long-term government [unintelligible -- 00:26:25], Operation Twist remember, there was under Martin [unintelligible -- 00:26:31] was being cooperative.

Robert L. Hetzel: Well, did you have a sense of how important it was for Martin to try to get a consensus with the administration economists before he moved in monetary policy?

Robert Solomon: Well, I doubt that he did that.

Robert L. Hetzel: I couldn't quite hear you.

Robert Solomon: I'm sorry. The Fed tradition of independence, given the Fed tradition of independence, I doubt that he would discuss specific monetary policy actions with them. He might discuss the general situation, but I'd be surprised that he would sort of try out specific policy options on them. I don't know. I'm just guessing.

Robert L. Hetzel: Well, what kind of sense did you have from the middle of 1977-- I'm sorry, 1967 through summer, say, of 1968? I mean, there was a consensus between the administration economists and the Fed in early '67 that since there wasn't going to be an imminent tax increase, monetary policy had to tighten.

Robert Solomon: But then we had a weakening of the economy, didn't we?

Robert L. Hetzel: Yeah. The unemployment rate never rose, but industrial production fell sharply.

Robert Solomon: That's right.

Robert L. Hetzel: And housing. Housing starts fell by 50 percent.

Robert Solomon: What fell?

Robert L. Hetzel: Housing starts.

Robert Solomon: Yeah.

Robert L. Hetzel: So Congress went through the--I guess that was the first time the Fed really caught the attention of Congress in a major way. My general impression from reading at that time is that there was the Fed and administration economists hoped that they could put together a combined fiscal monetary policy that would have fiscal policy be restrictive and monetary policy fairly easy as a way of dealing with housing problems.

Robert Solomon: Plus the Vietnam War.

Robert L. Hetzel: Does that sound...

Robert Solomon: That's right. I mean, the Treasury was certainly trying to put through a tax increase. I've forgotten the nature of it now, but...

Robert L. Hetzel: It was a surcharge eventually, yeah. Martin lobbied congressmen for a tax increase?

Robert Solomon: I don't know. I wouldn't know that. He would certainly have been in favor of it, but I don't know whether he lobbied.

Robert L. Hetzel: Do you remember at the time...

Robert Solomon: I mean, he could well have. I just don't know.

Robert L. Hetzel: Do you remember at the time having the feeling that at some point monetary policy became too expansionary? Do you remember at all the debates that took place around spring, summer of '68 when the tax surcharge went into effect?

Robert Solomon: I don't. You know, that was a period of turmoil on in the international side.

Robert L. Hetzel: Right.

Robert Solomon: Which I was in charge of.

Robert L. Hetzel: Yeah, I guess there were a lot of...

Robert Solomon: Sterling devaluation. Gold rush, as it were.

Robert L. Hetzel: You were spending a lot of time on airplanes, I gathered from your book.

Robert Solomon: I was going back and forth and we had—and the FDR thing was coming to a head. And I didn't have much time to devote to the domestic side of things.

{00:30:00}

Robert L. Hetzel: What were you telling to Europeans as far as the extent to which the United States should abide by the discipline of the Bretton Woods standard and the classical gold standard?

Robert Solomon: We were trying to get rid of the gold standard. But, I mean, that was in regard to the FDR, at least to get to get going, reduce the reliance of the system on gold. We didn't think in terms of being on the gold standard, as far as the gold standard rules and guidelines where policy are concerned. I don't think we thought in those terms.

Robert L. Hetzel: So you weren't thinking in terms of the Bretton Woods standard as exercising a discipline on U.S. domestic monetary policy. You personally.

Robert Solomon: No. I think we still thought that it was the domestic economy that determined the standards of monetary policy, and we tried to deal with international problems in other ways.

Robert L. Hetzel: At some point did you become pessimistic about maintaining convertibility of the dollar through non-monetary means?

Robert Solomon: Only later on.

Robert L. Hetzel: Not until the early 70s.

Robert Solomon: '70, '71. That's right. We did not think of the dollar as being overvalued. What was happening to sterling was putting pressure on the dollar because it was the other reserve currency. And we tried. The U.S. government tried obviously much too hard and much too long to keep sterling from devaluing which it finally had to do in November, '67. [00:32:08] We all turned handsprings trying to hold that sterling rate. It became silly.

Robert L. Hetzel: Yeah, that's in your book.

Robert Solomon: You remember that, then. I haven't read that book. Anyway, but I think we didn't think of determining or altering monetary policies for that reason at that time. We didn't think there was a basic [unintelligible -- 00:32:43] in the U.S. accounts. We thought that, yes, there was a deficit which had gone on for some years. Some people thought that deficit was inevitable given the nature of the monetary system and that there was no other way of supplying reserves to the rest of the world [unintelligible -- 00:33:00] the small trickle

of gold. And the U.S. overall deficit, which consisted of a capital outflow that exceeded the current account surplus, the current account was still in surplus until the late 60s or early 70s. We didn't think in terms of an exchange rate that was overvalued. We were thinking in terms of a system that needed to be reformed, that there would be a source of supply of reserves to other countries other than dollars, namely the SDR, other than dollars and gold.

Robert L. Hetzel: That's interesting. What did you think of the interest equalization tax? Did you think that was an important...

Robert Solomon: Well, that was just one we--because we thought the problem was an excess capital outflow relevant to the current account surplus and that tended to be blamed, in part, on underdeveloped capital markets in Europe. Doug Dillon made a lot of that in his various speeches. [00:34:00] I guess we thought it would be necessary to limit the capital outflow, and so we had the IET, which was first proposed by Roosa way back in '63, I think, and then the various other capital outflow restrictions on bank loans and direct investments.

Robert L. Hetzel: Looking back at it from the vantage point now of having 25 more years to think about it, do you think that was right? Or do you think that if the Bretton Woods system was going to work that U.S. domestic monetary policy would have had to accept more of a sense of discipline, say, an international gold standard?.

Robert Solomon: No. I don't think in those terms. I do think it was the nature of the system.

{00:35:00}

Robert L. Hetzel: Well, then why did the system...

Robert Solomon: The system was unsustainable. I mean, Triffin was right--the Triffin dilemma stated it pretty well.

Robert L. Hetzel: The system was unsustainable because there was no way to provide for growth in reserves?

Robert Solomon: There was no way to provide for growth in reserves. And in those days--it's hard to imagine that today because the world is so different today. But reserves, the balance of payments positions [00:35:21] showed up in countries' reserves, whereas today one thinks in terms of current account balances. Reserves are not terribly important, but they were in those days. It's almost synonymous where the change in a country's reserves is the measure of its balance of payments, and most countries wanted to have growing reserves. And when their reserves were not going up, they tended to react. Countries other than the United States, that is, and their policy tended to be--it was a very different system, and as I look back on it, [00:36:00] it wasn't sustainable.

Robert L. Hetzel: It would have been deflationary if it had been enforced ultimately.

Robert Solomon: Well, if we had been forced to, if the U.S. had been forced to get rid of its deficit, I guess we did find [00:36:20] those capital controls and when monetary policy tightened up after that short '67 recession, we actually had a surplus. And the way we calculated the balance of payment at that time which was a settlements basis of the capital accounts [unintelligible -- 00:36:36]. Another way to say it is that the U.S. liabilities [unintelligible -- 00:36:41] monetary authorities, foreign dollar holdings started going down, partly because of the high interest rates here. Those high interest rates being the result of a tight monetary policy that was aimed at the domestic economy, not for international reasons. But nevertheless, it did produce that surplus for a couple of years. You may not remember that, but that background...

Robert L. Hetzel: Yeah. Actually, I read that in your book.

Robert Solomon: That, in turn, provided the basis for the agreement on SDRs. [00:37:12]. Other countries were willing to agree to SDRs because their reserves were going down.

Robert L. Hetzel: If countries had been more willing to change exchange rates periodically, would that have made the system work also?

Robert Solomon: Well, I'm writing about that at the moment. But, yeah. I mean, I think that was the big mistake in the 1960s. There's too much emphasis [unintelligible -- 00:37:50]. The Japanese weren't all that important, so I don't mention that. Too much stress on the reserve system and not enough on what we call the adjustment process, particularly on exchange rates. We tried (this is in the book too) to start a reform of the exchange rate [unintelligible -- 00:38:08]. I've seen this National Bureau book edited by Bordo and Eichengren [00:38:13] called *A Retrospective on the Bretton Wood System*.

Robert L. Hetzel: Yes.

Robert Solomon: Okay. Well, I have a very--sorry to keep referring to my own stuff, but...

Robert L. Hetzel: No. That's why we're talking.

Robert Solomon: I have a short piece in there called, "The Perspective of Policy Making," which discusses this a little bit, the subject we are now talking about. I think there's also in the book a little chapter called, "The Reform that Failed" about the failure or the attempts that failed to do something about interest rate [unintelligible -- 00:38:48].

Robert L. Hetzel: So you don't think it was pre-ordained that we had to go on a floating exchange rate system in the 70s.

Robert Solomon: That's right. If we'd been willing to go to a more flexible exchange regime under the old system, that might have saved it. But the problem was--and this is what comes out in the Bretton Woods retrospective book. The point I make there is

that that would have been an asymmetrical system. Given the link of the dollar to gold, the U.S. couldn't change its own exchange rate. [unintelligible -- 00:39:27] flexibility, everybody else had to flex and we would have remained passive, and that was just unacceptable...

Robert L. Hetzel: That's right.

Robert Solomon: ...to the rest of the world. So it may well be that [00:39:36] the demise of Bretton Woods was inevitable.

Robert L. Hetzel: Well, Germany and France and then later Japan weren't willing to--at that point weren't willing to revalue their...

Robert Solomon: Well, Germany did once in '69 for its own reasons, but it was a Deutsche Mark devaluation.

Robert L. Hetzel: Right.

Robert Solomon: [unintelligible -- 00:39:58].

{00:40:03}

Robert L. Hetzel: Okay. Do you have impressions about Burns when he became Chairman in the early 70s? Is that a period we could talk about? Do you have a sense of how Burns looked at the world as an economist? I mean, he didn't view himself as either a monetarist or a Keynesian [00:40:27], so what was he?

Robert Solomon: Well, I don't know what he was. He was a very strange duck. I don't know.

Robert L. Hetzel: I won't quote that, either, but...

Robert Solomon: No. No. Very smart. Extremely smart. Tremendous ego. He had to be the smartest man in the room and often was.

Robert L. Hetzel: Sure. That was part of the problem. He was the smartest. Nobody could challenge him.

Robert Solomon: He wasn't always.

Robert L. Hetzel: Well, who could--who was as smart as--was he ever in a situation that somebody could challenge him?

Robert Solomon: Oh, not very often, no. And when they did, he created problems. I was one of those who challenged him from time to time privately.

Robert L. Hetzel: You did?

Robert Solomon: Well, sure. When I thought he was wrong, I told him so. I was an advisor to the Board, after all. It was private, but...

Robert L. Hetzel: Do you remember particular arguments that you'd have?

Robert Solomon: I just remember that the relationship between us was rather strained at times. A couple of governors tried to act as mediators. But to give you specifics, I can't. Well, I'll just say a couple other things about him. Two things. One, he had a great attachment to gold for reasons that I never understood. He went around Europe just before. In the first year of the Nixon Administration, he was in the White House. He came to the Fed only a year later during Martin's term. He went around Europe making speeches and talking to people and talking up some sort of a--something about a return to gold standard. It was a strange thing to be doing at that time.

Robert L. Hetzel: Well, he was famous at the Camp David meeting for--keeping the meeting going so long, like an FOMC meeting, trying to persuade Nixon not to close the gold window. So that must have been the source of--from what you've just told me, that must have been a source of arguments between you and Burns, the role of SDRs, as opposed to...

Robert Solomon: Right, because I was one of the promoters of the SDR.

Robert L. Hetzel: And the idea of creating international liquidity in that way--it sounds like from what you said that he wasn't...

Robert Solomon: Yeah, the major thing he was is author of a fixed exchanged rate. He had a great--and having lived through the 30s as an adult, which I hadn't done, he was very much influenced by the instability in exchange rates and competitive depreciation and all the other things that happened in the 30s and was there for a very suspicious--about proposals for greater exchange rate flexibility and certainly about floating exchange rates.

Robert L. Hetzel: Well, I guess Volcker was the same way, wasn't he?

Robert Solomon: Less so. Volcker understood--accepted that it had to happen. But he's never been happy with it.

Robert L. Hetzel: But it seems like...

Robert Solomon: He's at the moment. Paul, for example, is sort of a mild proponent of target zones, [00:43:55] but very mild. And he thinks we're not quite ready for it. It's not a very strongly-held view with him as it was with Burns. I wouldn't compare the two.

Robert L. Hetzel: Well, yeah, I can't exactly guess what must have been going on in Burns' head because he consistently--I mean, for the first three years he consistently moved the FOMC toward a more expansionary monetary policy, right or wrong.

Robert Solomon: Yeah, that's right. In '72 and that's the real problem. Did he do this for political reasons?

Robert L. Hetzel: Well, it was before...

Robert Solomon: I don't know the answer to that question. I'm not going to give you any opinions on it. I'd just say a couple of things. One, there were some stories but you may or may not come across which claim. At least at one FOMC meeting he went out of the room and took a call from the White House and came back in and said, you know, "The President doesn't want us to do this" or something like that or wants us to do this.

{00:44:55}

Robert L. Hetzel: Yes. Our principals were there at that time, Al Broadus [00:45:00] and Bob Black and they say that at one point Burns huddled with his staff trying to get put together an alternative that would be acceptable to the FOMC, and that must have been misinterpreted somehow.

Robert Solomon: Burns was much too [unintelligible -- 00:45:19] of a man to ever do a thing like that. Even if he had been on the phone, he would never do that. But I have no doubt that a majority of the committee and of the staff felt we should be tightening in '72. The staff was unanimous on that and he managed to hold it back. Now, you know, you make your own judgment about why.

Robert L. Hetzel: We'll come back to '72 in a minute, but there were really three times when he moved the committee decisively. When he came in as Chairman, the FOMC was still committed to a sharp recession. They were going to keep the funds rate up until inflation actually was going to come down, and Al Hayes led that group and Burns wanted the McCracken gradualism. And in his first meeting there was a big fight over that.

[End of Tape 1 at 00:46:14].

[Beginning of Tape 2]

Robert L. Hetzel: And then toward the end of '70 when it looked like unemployment was going to stay high throughout '71, the Board pushed the funds rate down rather aggressively by pushing the discount rate down before FOMC meetings. And so monetary policy really became more expansionary...

Robert Solomon: That may have well have contributed to the...

Robert L. Hetzel: ...late in '70.

Robert Solomon: ...international crisis.

Robert L. Hetzel: Well, yeah. I'm sure it did. And then in '72 I remember that period because I came not too long after that. The Committee had agreed to move toward Mazel's proposal for targeting reserves available to support private deposits. And the very first time the FOMC was to target reserves, the funds rates started rising. That was, I guess, February of '72 and, you know, Burns squelched it. So I think a lot of people felt like he had squelched the reserve experiment, which would have been the right thing to do because it would have let rates rise. Although as you got into '72, there is this tradition that the Fed--or at least at that time before Volcker, there was this tradition that the Fed doesn't raise interest rates before a presidential election.

Robert Solomon: That wouldn't hold for the Spring of the year.

Robert L. Hetzel: Right.

Robert Solomon: That would hold for...

Robert L. Hetzel: Right. Later on. So, yeah, the Spring of the year. That's the hardest.

Robert Solomon: It wouldn't change in either direction.

Robert L. Hetzel: Yeah. That's the hardest part to explain, early '72.

Robert Solomon: It is. And I...

Robert L. Hetzel: People have lots of explanations. One explanation is that Burns really did believe that the wage and price controls were important and that labor needed to--to make them work, they needed to keep labor on. And if interest rates rose, labor wouldn't be a part of it and he thought he could keep rates low enough so that labor would continue to support the controls.

Robert Solomon: Well, that could be. I don't know. You have to entertain the other hypothesis and he was trying to help ensure that Richard Nixon got re-elected. I don't know if that's true. I can't read his mind. In retrospect, I'm just--it is a hypothesis that has to be considered.

Robert L. Hetzel: Yeah, my feeling is that this is somebody who thought he could control the economy, and he overestimated his ability to control, and he really thought he could move the unemployment rate down to four percent with little inflation as long as he had the controls. And it was a challenge to somebody who thought he could--as I say, who wanted to control and wanted to be part of decision making. And my guess is if there had been a Democrat in office, he probably would have done very much the same thing. So in that sense, it wasn't partisan, although it was political in the sense that the agenda was set...

Robert Solomon: It could have been both.

Robert L. Hetzel: The agenda was set by the political system. And he though, well, yeah, I can do it. And he just overestimated his ability to control.

Robert Solomon: It might well be. There's no doubt that he was--I mentioned his ego earlier. This is consistent with the fact that he had great confidence in his own judgment.

Robert L. Hetzel: Well, and he wanted to be part of decision making within the administration. Again, that could have been any administration. And if you feel that way, you can't be too far out from the consensus or you're not going to be a player. So that could have had some influence, too, I suppose.

Robert Solomon: That's a tough one.

Robert L. Hetzel: Okay. Well, let me...

Robert Solomon: It's now getting to the point where I'm about to fade out because in '72 I went off for two years to the Committee of 20.

Robert L. Hetzel: Let me ask you. There's a couple of things I want to ask you about. Kind of special topics. One is the exchange rate intervention in the '77-'78 period. And then one is the more recent period, '86-'87. I was just fascinated by this account in your book of exchange rate intervention in the '77-'78 period. That is, you know, the U.S. began to run a current account deficit in '77 and '78.

Robert Solomon: Well, it was similar to the present situation. We were recovering ahead of Europe. We were growing faster.

Robert L. Hetzel: Yeah, and Blumenthal made the statement which was interpreted as his wanting to talk the dollar down.

Robert Solomon: Right.

Robert L. Hetzel: And then, sure enough, the dollar fell sharply and that caused a lot of grief in Europe. You mentioned that President Carter flew to Saudi Arabia to express his concern about the fall and the value of the dollar. And so, you know, the Treasury had a problem, and it wanted to express its concern that it was not trying to depreciate the dollar. And so the Fed and the Treasury got involved heavily in foreign exchange intervention. And then later on, the Fed raised the discount rate.

Robert Solomon: I think it was November 1 the stabilization action with Carter bonds and all that.

Robert L. Hetzel: Right. It just made me think so much of the current period when I was reading through this.

Robert Solomon: Well, many people have made that--rates are, I don't think rates have moved anywhere near as far probably, but maybe [unintelligible -- 00:53:01].

Robert L. Hetzel: But just in terms of kind of the politics and how the Fed gets involved in these things. Wasn't it earlier--not this year but last year that several members of the Clinton Administration kind of made comments to the effect that they'd like to see a stronger yen. And they weren't coordinated. They were personal comments.

Robert Solomon: Yeah, Benson did and...

Robert L. Hetzel: And then Summers, I guess, and...

Robert Solomon: I think the president may have also.

Robert L. Hetzel: It was either Tyson or...

Robert Solomon: I doubt that either Tyson or Larry would have done that, but I could be wrong.

Robert L. Hetzel: Anyway, several--maybe it was Manell. Several members made unrelated comments in a fairly short period of time. They liked to see the yen stronger. And then from then on, there was this perception that the U.S. was trying to talk...

Robert Solomon: Talk up the yen.

Robert L. Hetzel: Talk up the yen. And when the yen did then rise and with the Japanese recession, then it really got to be a problem. It's '77-'78, so you did the exchange intervention, but then that puts the Fed in a really ticklish spot. I think most people feel like if sterilized intervention's going to work, it's got to convey some kind of policy signal that the Fed cares about...

Robert Solomon: That's the cycle of Dominguez view, right. [00:54:30].

Robert L. Hetzel: But that kind of boxes the Fed in. If you're involved in foreign exchange intervention for foreign policy or for foreign reasons, the Treasury's going to take the lead. You got to wonder how independent is Fed action. And so the Fed's kind of...

Robert Solomon: But sterilized intervention doesn't affect monetary policy--I don't see why it's...

Robert L. Hetzel: Well, but there is this perception now that sterilized intervention, per se, doesn't work. And if it's going to work, it's got to be followed by Fed actions. So the Fed gets itself in a box. Either it fouls up by changing the fund's rate, in which case it's viewed as following the Treasury's lead.

Robert Solomon: Well, it could do on the basis that it's on independent judgment. That doesn't necessarily imply a loss of independence to me.

Robert L. Hetzel: Okay. Well, I wanted your opinion on it.

Robert Solomon: In most countries you'd say the Central Bank is more sensitive than the Treasury to exchange rate [unintelligible -- 00:55:37] is in Germany.

Robert L. Hetzel: Okay.

Robert Solomon: And it might on its own initiative, but I don't see it as necessarily prejudicial to...

Robert L. Hetzel: Okay. So you still think there's a valid role for the Fed to be involved in sterilized intervention, and it was appropriate what we did recently.

Robert Solomon: Sure, without any question, but you were now going beyond that, whether you [00:56:02] wiggle monetary policy for exchange rate reasons.

Robert L. Hetzel: OK. And the last period I want to ask you about is '86-'87. I know you weren't in the Fed then, but obviously you've got to have opinions about it, and I'm interested in getting those opinions, at least your perception of what was going on.

[00:56:25]

Robert Solomon: In the Louvre?

Robert L. Hetzel: Yes, from Plaza through Louvre and through '87. Basically, what I'm interested in the extent to which Volcker's behavior in this period of '86 through '87 was influenced by international considerations and just kind of what feeling you have about that.

Robert Solomon: Let's see. The Louvre came in February of '87. Until then, the dollar had been going down to reverse the enormous appreciation of the first half of the 80s.

Robert L. Hetzel: Right.

Robert Solomon: The Plaza started that--well, actually, it started out even before the Plaza Agreement. The Plaza was an official agreement that the dollar should go back down. And I think Paul--you'll want to look at--if you haven't done so. I forgot if we mentioned this last time, the Volcker book is useful. Volcker started to be concerned about how far the dollar was going, but maybe it had gone down far enough even before the Louvre if I'm not mistaken. Anyway, the Louvre agreement came in February. My own view of what happened thereafter--and this is '87, not '86.

Robert L. Hetzel: Right.

Robert Solomon: The market didn't think that the dollar had gone down enough. The market, so to speak. People in the market. My impression is that was the general view, that it had to go further. And my impression also is that for Baker, the architect of the Louvre--the Louvre was sort of a temporary thing to give breathing space to Germany and

Japan and the others to absorb, to adjust to the extent of the exchange rate, the change that had taken place in '85. That was a big appreciation for their currencies, and he was concerned about it then.

Robert L. Hetzel: Well, didn't--sorry.

Robert Solomon: In any event, it was because the market didn't--thought the dollar was going to have to go down further despite the Louvre agreement that you had to have so much intervention to try to enforce the Louvre to hold those exchange rates. But that expectation of dollar depreciation is what led to the rise in interest rates. Long-term interest rates rose very sharply.

Robert L. Hetzel: Right, early '87.

Robert Solomon: Let me interrupt and ask you. Do you see this monthly letter I publish that comes to Richmond?

Robert L. Hetzel: No, I'm sorry. It does come to Richmond?

Robert Solomon: It's called the international economic letter.

Robert L. Hetzel: I'm sorry, no.

Robert Solomon: Well, I assume somebody has--it goes to--is Black still president?

Robert L. Hetzel: No. He's retired.

Robert Solomon: Who's the present president?

Robert L. Hetzel: Al Broaddus.

Robert Solomon: Broaddus? Well, let see. I hope it's still going there.

Robert L. Hetzel: Okay. Well, I'll definitely...

Robert Solomon: Your library or his office should have a file of these letters. I've been publishing this since 1981.

Robert L. Hetzel: No. That sounds wonderful.

Robert Solomon: If you're interested in history, you'll find some analysis that I did at that time and since about what was going on in markets in '87 in those letters. If you have trouble finding them, let me know. I can send some to you. I don't remember everything I wrote, but I was following it pretty closely and trying to interpret what was going on at that time. Okay. That's just a parenthesis.

Robert L. Hetzel: Okay. I apologize for not being aware of it because if I would have known about this, I would have been reading it since 1981. Sorry.

Robert Solomon: Okay. As soon as we finish, I'll check to be sure that it's going to Broadus. It certainly should be. It went to Bob Black for all those years.

Robert L. Hetzel: Okay. Well, I'll check with our library. But at that time, Volcker was--there was a lot of tension in the international trade situation. It seemed like the coalition that had supported free trade in the U.S. might have broken down, especially with Toshiba.

Robert Solomon: Well, that was even earlier. That's one reason for the Plaza.

Robert L. Hetzel: '86, yeah.

Robert Solomon: '85. Baker was worried. I mean, the appreciation of the dollar from '80 to '85. I have characterized it as the largest real appreciation of currency of a major country in modern history. It was 80 percent in nominal terms and pretty close to 70 percent in real terms.

{01:01:23}

Robert L. Hetzel: Right.

Robert Solomon: Enormous. I can't think of any other country that could have withstood that big a change in its exchange rate. Anyway, there started to be protectionist pressures up on the hill, naturally, given the extent to which the dollar had gone up. And I think what motivated Baker to instigate the Plaza was that.

Robert L. Hetzel: But Volcker's actions in that period must have been motivated partly by desire to persuade the German and Japanese Central Banks, that they should pursue a more expansionary policy as a way of stimulating their economies and bringing in more U.S. exports.

Robert Solomon: I just don't know what he was doing then.

Robert L. Hetzel: Do you think there was a relationship between flight from the dollar and the stock market crash in '87?

Robert Solomon: Well, the relationship I saw was the rise in interest rates and he expected a rise in interest rates having an effect on the stock market and is doing these days. But beyond that, the stock market itself had risen by a very large amount in '87. I think it was due for a reversal. It didn't have to be a crash, but it was at least due for a reversal in any event. I looked at these numbers just recently. Just take a look at how much the market went up, what happened to price earnings ratios and so on in the beginning of '87 to October. And I remember myself, a small investor that I am, saying to myself, "Boy, I really ought to get

out of the stock market” in the summer of ’87, but I didn’t want to pay capital gains taxes so I didn’t do it.

Robert L. Hetzel: Okay.

Robert Solomon: Anyway, I just gave you that personal recollection only to tell you that it seemed to me long before the crash occurred that the market had gone up one hell of a lot. So I think there’s a combination of explanations for Black--whatever day it was. That stock market crash in October. By coincidence, I was at a meeting at the Richmond Fed that day.

Robert L. Hetzel: Yeah, that was a conference I set up and I actually met you at that time.

Robert Solomon: Okay. I can sure remember driving down. I drove down. Driving back from Richmond, having my radio on, just listening to all these reports about the stock market. Well, people came into the meeting every now and then or to lunch and told us what was going on.

Robert L. Hetzel: Well, I was the first one who told you. And I remember the expression on your face. You said something like, “Oh my God.”

Robert Solomon: Did I really? Yeah.

Robert L. Hetzel: Yeah. So that was the--we’ve actually met and that was the occasion.

Robert Solomon: All right. Okay.

Robert L. Hetzel: Well, this has been very interesting.

Robert Solomon: Well, I hope it’s helpful.

Robert L. Hetzel: I really appreciate talking to you. And think about it. If you want to...

(END OF RECORDING)