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RENOMINATION OF PAUL A. VOLCKER

HEARING

BEFORE THE

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

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

THE RENOMINATION OF PAUL A. VOLCKER TO BE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, FOR A TERM OF 4 YEARS ENDING AUGUST 6, 1987

JULY 14, 1983

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

THURSDAY, JULY 14, 1983

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

The committee met at 9:30 in room SR-325, Russell Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Heinz, D'Amato, Gorton, Hawkins, Mattingly, Hecht, Trible, Proxmire, Riegle, Sarbanes, Dodd, Dixon, Sasser, and Lautenberg.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

I'm sure everyone is aware that the purpose of this morning's hearing is to conduct the reconfirmation hearings for Paul A. Volcker to be Chairman of the Federal Reserve Board.

Mr. Volcker, when you assumed the chairmanship of the Board of Governors of the Federal Reserve System in August 1979, you inherited an extremely difficult and precarious economic situation. That year consumer prices were rising at the rate of over 13 percent and building inflationary expectations were pushing interest rates upward to unprecedented levels. Putting our economic house back in order required major changes in both the Federal Reserve's monetary policy as well as in fiscal policy.

While I have many times been critical of specific Federal Reserve actions since you have been chairman, I believe you have accomplished the basic redirection of monetary policy that was essential to restoring our economy to a low inflation growth path. It is for this reason that as long ago as mid-March, I publicly supported your reappointment as Chairman of the Board of Governors.

Under your leadership the Federal Reserve certainly has acted more responsibly in redirecting monetary policy than the Congress has acted in redirecting fiscal policy. On that point I want to stress that, as we look at the difficulties of this economy, the past high interest rates, high unemployment, and the lack of growth that we have experienced, I'm amazed at how well Congress has been able to get away with placing a majority of the blame on the Federal Reserve Board. We simply cannot separate monetary and fiscal policy. They must work closely together. Congress, as is very evident, has not worked very closely in trying to match fiscal policy with monetary policy. The proof of that is the ever-increasing deficits that we face, and Congress unwillingness to significantly cut those deficits. It is my feeling that Congress must face up realistically to those budget deficits and send the proper signals to the financial markets of this country: That we are redirecting fiscal policy, that they can anticipate lower deficits and eventually balanced budgets in this country, that interest rates will continue to stay at high levels.

There is simply no reason why the financial markets should believe Presidents or Congresses. In my 9 years, I have not seen us even approach targets for fiscal policy that we have anticipated or said that we would. Every President comes into office promising to balance the budget before the end of his first term. Every President fails miserably. Every Congressman and Senator runs for reelection on the basis that he will be fiscally responsible and work for balanced budgets. Despite all the rhetoric, all we have had is increasing budget deficits. I look back to the 1950's and the 1960's and I would doubt very much that most people knew what the Federal Reserve Board was or who the Chairman was. If we had a stable fiscal policy the Fed would be in the background once again.

I certainly do not say that the Fed does not have a major role to play in all of this. It does. Your decisions are important, but certainly the blame and the credit must be shared. I believe the Fed has done a much better job in this economic situation than has the Congress of the United States. It is time we started putting our act together, making the job of the Fed managing the money supply much easier.

We are meeting this morning, Mr. Chairman, on the day following the conclusion of a meeting of the Federal Open Market Committee. I know that with the timing of this confirmation hearing, it is not possible for you to discuss in great detail monetary policy objectives of the Fed for the next 12 months. We are caught in a situation where this hearing is required by law. You are required to appear before the Banking Committee twice a year under the Humphrey-Hawkins Act and that coincidentally occurs next week when you will be detailing your objectives for the next 12 months. As I would expect members of the committee would like detailed answers to those questions and you are not able to give them today, it seemed wiser to me to defer a vote on your nomination until after we had held the Humphrey-Hawkins hearings. So that will be the procedure of the committee. We will hold hearings this morning with you as the witness and this afternoon back in the Banking Committee hearing room we will hold additional hearings based on those who wish to speak either for or in opposition to your renomination. Then next week we will hold the normal 6-month Humphrey-Hawkins hearings and after those have been completed, when you're more at liberty to speak in specific detail about the actions of the Federal Open Market Committee, then I would intend to call the committee together for a vote on your nomination.

Senator Proxmire.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you, Mr. Chairman.

For the next 4 years, Chairman Volcker, you will have a job that will certainly bring you more condemnation, denunciation, criticism, and at the end the overwhelming likelihood of failure. You are about to ride into the valley of death with your present reputation. You could become a Herbert Hoover of monetary policy. You will be the fall guy who takes a Niagara Falls dive for a necessity to stagger along with the weight of a great debt. You will use your very great skill and experience with the support you have won with the American public to lessen the misery. You will do a good job, better than anybody else could do, but make no mistake about it, Chairman Volcker, these will be 4 bad years.

What makes it worse, Mr. Chairman, is you start off with the warm approval of almost everyone and with the blind high hopes of everyone that somehow you can keep interest rates down and produce all the credit in the economy that homebuilding is going to need and that auto buyers will need and farmers will need and businessmen will need, while at the same time keeping that same superprofessional grip on inflation that you have mastered so conspicuously over the past 4 years. Well, you just won't do it. You can't. No one could.

I think we owe you, Chairman Volcker, a rousing vote of thanks for your great job in bringing inflation down. In 1979 when you took office, yours was the only anti-inflation game in town. Meanwhile, between the Congress and the administration, two administrations, we sharply increased spending, reduced Federal revenues in relationship to our needs, and created not just a single year's deficit but the assurance that we will have a series of deficits and explode the national debt to more than $2 trillion over the next 4 years or so.

About an hour or so ago I talked with your predecessor, former Federal Reserve Chairman William Miller, who was as you know also Secretary of the Treasury, and he told me that I could say this morning that you have an impossible job and that there's no way that you can succeed or that monetary policy can succeed. It becomes a passive instrument when we have the kind of fiscal policy we are following. And for some 26 years I have been sitting on this committee listening to able Fed Chairmen like William McChesney Martin and Arthur Burns and you tell us that monetary policy cannot do its job of keeping inflation under control on a long-term basis without a responsible fiscal policy that holds down Federal borrowing. Brother, have we ignored that advice. We have created a mammoth, ponderous, fire-eating dragon and monster. Think of it—deficits not of $40 billion, $50 billion, or $60 billion, but this year we would have more than a $200 billion deficit. In my judgment, we will have deficits at least that big or bigger for every 1 of the next 4 years, while Paul Volcker will be chairing the Federal Reserve Board.

Now some will say take it easy; things aren't really as bad as all that, or are they? Consider, this moment and for the next few weeks and months, the economic situation looks improving. Nominal interest rates are still down to about half their level of a couple years ago. Inflation has dropped to a 5-percent level or below. Even unemployment is improving, and the leading indicators have been giving off a volume of plus signals month after month. These are leading indicators—I repeat, leading indicators. They should foretell what will happen to the economy over the next few months and they probably do. Let us not kid ourselves. The day of reckoning is not at hand, but it is coming. With massive Federal borrowing the economy cannot keep up unless we get a torrent of credit from you and the Federal Reserve Board. As our recovery moves ahead, plus as the international economy—that is, the world economic recovery of other countries finds its footing, the demand for money can do nothing but accelerate, plus the colossal Federal demand for funds, we know for certain that means that the Fed will feed it or interest rates will skyrocket.

There are optimists. They tell us, don't fret; we still have an enormous pool of unemployed workers; no inflationary pressure on wages in sight; we have vast unused industrial capacity and no pressure from higher prices from this country or anyplace else in the world. We have a huge capacity to produce commodities of all kinds and the global economy will keep its cool, so why not relax? Where is the pressure coming from?

And all this is just another way of saying that we still have a few months, maybe a year or so, of relative easy times of recovery without inflation, but the time is coming and certainly within the next 4 Volcker years when inflation or high interest rates or both will choke off this recovery.

So, good luck, Paul, you poor devil. [Laughter.]

Now, Chairman Volcker, I just have one more thing to say. I haven't mentioned the fact that as a principal bank regulator you will preside over the Federal Reserve during the next 4 years when we will see our 30,000 financial institutions adjust to the most dramatic structural changes in our history. With the initiative of this committee we have erased most of the barriers that have prevented competition between banks, savings and loans, and credit unions. We have reduced restrictions for banks to get into other businesses and other business to get into banking.

In the process we have left a great deal to the five agencies, including the credit union regulator, to regulate the financial institutions. The adjustment would be painful and difficult if we had one regulator. With five regulators, it will be a matter of compromise and negotiation and accepting partial and often inadequate adjustments.

So in all these areas, Mr. Chairman, I can just say, as Hamlet said, and with the same feeling of deep black mourning to the skull of his old, dear, dead friend, "Alas, poor Yorick." I say, "Alas, poor Volcker." [Laughter.]

The CHAIRMAN. May I say to my distinguished colleague, the ranking minority member and former distinguished chairman of this committee, and note for the record, that we are in absolute agreement. Until our fiscal house is put in order, Chairman Volcker has a virtually impossible task, but I can't help but also note that, although our statements were similar, Senator Proxmire so much more eloquently and with so much more humor, I'm so impressed with your statement I wish I had said it in that manner.

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Thank you, Mr. Chairman.

Chairman Volcker, I'm not going to be nearly as eloquent as Senator Proxmire, although I happen to agree with Senator Proxmire's assessment. I would make a slightly more low key observation which is this: your terms as President of the New York Fed and as Chairman of the Federal Reserve Board have spanned a decade of extraordinarily turbulent times. During that period, we have had three recessions, a near-constant increase in Federal deficits, a continually rising unemployment, a half a dozen or more record-breaking peaks in interest rates, and until 1980 what appeared to be an endless cycle of runaway inflation. I cannot think of a more difficult set of circumstances under which to develop and to practice the art of conducting monetary policy. That is your responsibility, of course.

During my tenure on this committee I have seen your expertise and that of your colleagues on the Federal Reserve Board mature. Frankly, in the 1978, 1979, and 1980 period I thought you made some mistakes, but I do think that you and your colleagues have matured and in a time when the economy itself is defying traditional theories of economic behavior, old theories of monetary policy and management have had to be refined and reshaped to reflect new realities. You have experimented. You have not always succeeded, but in recent years you do appear to have attained a level of sophistication in monetary policy and its implementation that has allowed you and the Board to hold the path of our economy to a very narrow channel, that channel being one between the reignition of inflation and the reversion to economic stagnation.

It is this accomplishment of recent years that has brought you your nomination for reappointment and has earned you the respect of the financial community, both at home and abroad, and a reputation for professionalism and consistency.

This confirmation hearing today is your opportunity—indeed I think it is a necessity—to reassure all the members of this committee and the public at large that your reputation for keen, moderate judgment remains well-founded. While we may all hope for a quiet and prosperous economic future, the road that we have to travel to get there may hold some very great surprises. Traveling smoothly on that road is going to necessitate your having a strong hand at the steering wheel, a firm hand on the helm, and without it, we can steer to one side of the road or the other and if we go off the road, into inflation or into an economic tailspin.

You, whether you deserve it or not, as has been suggested by my colleagues, will get the blame. Let me say on a personal note that you have earned my deep, personal respect as a human being, as a man who has demonstrated continually the ability to learn to grow wiser, and to apply your new knowledge. I am confident that this committee will find that you are the individual with the best experience and the greatest resolve to continue the administration of monetary policy that avoids the tragedies of inflation and economic distress.

Let me only add one thought. I don't imagine that your hearing today is going to be totally without controversy, but to those who would give you a rough time, I would just ask them what kind of policy do they really want and what kind of a person do they want administering it? In this body you often think that all the votes you cast, and all the alternatives you're presented with and thinking of supporting are terrible until you consider the other alternatives. That is not meant to be a backhanded endorsement. It is a measure of the job. Anybody in your job has a terribly tough time and I hope that as people warm to the task of roasting the Federal Reserve, which is one of the all-time great Washington sports, that they will remember that the only thing worse than not having a Federal Reserve or a Federal Reserve Chairman to kick around is having someone that they are responsible for.

The Federal Reserve Board Chairman is the third most second-guessed position in America. You may wonder what the first two are. Well, obviously, the President leads the list as the most second-guessed person. Professional baseball managers are next. You follow in that fine tradition. Good luck, Paul.

The CHAIRMAN. Senator Riegle.

OPENING STATEMENT OF SENATOR RIEGLE

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Volcker, let me first congratulate you on your renomination. You have a most difficult job and I believe that you have given a full measure of personal effort and commitment to these important duties.

While I and others have sharply disagreed with certain of your past policy actions, your professionalism, hard work and deep personal commitment to public service are widely admired. You have always been candid and responsive to this committee and to me, and that is much appreciated. While I respect your professionalism and your valuable knowledge of the national and world financial system, I am deeply concerned about certain past Federal Reserve policy decisions that I feel have done far more harm than good. I wonder if we will see a return to those policies in the future.

Specifically, I believe we witnessed a period of excessive reliance on rigid monetarism at the Fed during your first term as Chairman which drove interest rates to record levels and, in turn, plunged the Nation and the world into the deepest recession since the Great Depression. Clearly, other negative factors were also at work, but deliberate Federal Reserve policies were a major cause of interest rates that were too high for too long.

The economic damage that resulted is measured in the hundreds of billions of dollars of profit reduction and in several million lost jobs. Our international trade status was also badly damaged and, as a matter of fact, the New York Times just 3 days ago ran a front page story which shows our merchandise trade deficit this year will be above $80 billion. Entire nations were driven to the edge of bankruptcy. My own State of Michigan is experiencing double-digit unemployment now for its 38th consecutive month, with the State government itself nearly driven into insolvency.

When business and financial bankruptcies began to cascade last year, the Fed clearly changed its policies and moved away from strict reliance on arbitrary monetary aggregates and growth targets. Interest rates declined sharply and an economic recovery began to occur. This brings us to the present moment where the Fed has been allowing money supply growth well above its announced targets and economic activity has accelerated. Now the Fed watchers are awaiting with keen interest and considerable apprehension a result of this week's Fed policy decisionmaking with respect to the future course of interest rates. It's page 1 news because the world financial and economic structure remains in a very fragile and perilous condition, as you well know.

Economic recovery must be sustained by appropriate monetary policies as well as by appropriate fiscal, trade, and international financing policies. While all these policies ought to be carefully synchronized to achieve the best possible result, a major miscalculation on monetary policy could stop the economic recovery in its tracks and subject the world economy to new dangers that I just don't think it can tolerate at this time.

So I'm profoundly concerned about the future direction of Fed policy and how in combination with other key policy variables future Fed policy is going to affect interest rates. President Reagan's press secretary, speaking for the President, just this week has given one instruction, presumably to yourself and to the Fed from President Reagan himself, that he does not want interest rates driven higher by Federal Reserve policy. So this concern extends from the Senate Banking Committee to the White House and from Main Street to Wall Street.

It is a profound matter of concern throughout the entire world. Every nation and every international financial center around the world fears high U.S. interest rates and has said so in the plainest language, as you well know. In fact, that was a major topic of conversation at the Williamsburg meeting. It is widely ackowledged that a sharp rise in U.S. interest rates will plunge the world economy back into recession or worse. In fact, the grave international financial problems would create a crisis of confidence unless wise and steady economic policy actions are taken by our Government and the Federal Reserve System.

You are highly regarded in international financial circles, and your international standing and reputation are valuable assets at a time of international financial instability and high risk. Some observers have gone as far as to suggest that that may have been a decisive factor in the White House decision to ask you to serve another term as Fed Chairman.

We here are charged with the confirmation responsibility for a position which I believe at this time stands only second in importance behind the job held by the President himself. We have only the options of accepting or rejecting your nomination, a nomination the President alone is empowered to make.

As a practical matter, all indications are that you're likely to be confirmed by a substantial vote, despite the deep concern that many members on both sides of the aisle have about future monetary policy intentions.

Our purpose here, then, is to do the best we can to help illuminate and place upon the record your policy intentions under a variety of financial circumstances and it's fair to say that the whole world is very intensely interested in what those responses will be today and in your subsequent hearings.

For example, one of the questions in this country, is if unemployment begins to rise again, at what point would the unemployment level itself prompt the Federal Reserve to reduce interest rates in order to stimulate recovery? What lessons has the Fed learned from its policies over the last 4 years? And while much has been said about fiscal policy, as it properly should be and there are many of us here who have worked very hard to try to preserve the budget process in the Congress and try to achieve fiscal restraint, I don't think that fiscal restraint alone can solve the problem of interest rates and tight money that are in an extreme degree, and, on the other hand, I don't think that a loose fiscal policy can be corrected by an inordinately tight monetary policy.

So my concern is that if we ever overdo it on the monetary side, I think the real risk now is that we could actually tip the world into a depression, and that's the last thing you or any of us here or anybody wants to see. So I would hope as we go through this discussion today with care and precision that we could get from you an indication as to what these future policies may look like and what the lessons are that have been learned. Then, we will be in a position to make some judgments together.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Thank you, Mr. Chairman.

Chairman Volcker, let me congratulate you for your renomination and for having covered the entire gamut in being praised, buried, pitied, and resurrected all at the same time.

The fact is that the business community is worried. They are concerned in terms of what the interest rates will do. There's a deep feeling afoot that the monetary policies of the Fed may unduly contribute to the rise in interest rates. This feeling is prevalent today not only in the business community but is also a matter of concern to individual citizens as we all have learned in making our rounds back home and talking to our people.

Indeed, I think that the economic prosperity of this country, whether we are going to continue to move forward in economic growth, is, to a large extent, to be determined by where interest rates will be. So to that extent, I would hope that you would be able to give to this committee your reflections as to what Fed policy in terms of monetary restrictions will be, and in terms of future attempts to curb inflationary growth utilizing the powers that you exercise at the Fed. That is going to be the key element, our primary concern. Will the Fed be unduly restrictive and thereby hamper the economic growth?

There are those who say that if we are able to maintain the present interest rate levels, we will have a strong economic recovery, not necessarily one that will return us to the dangerous and intolerable inflationary periods of the past and I would hope that in the course of your testimony you attempt to address this notion with some specificity.

Needless to say, I believe that your reappointment is supported by the domestic and international financial communities. However, the central, core question continues to resurface: Will we have a monetary policy that will be unduly restrictive thereby creating a situation where interest rates are higher than necessary to deal with the problems of inflation?

I wish you the best and I would hope that you would be able to address this concern.

The CHAIRMAN. Thank you, Senator D'Amato.

Senator Dodd.

Senator DODD. No opening statement, Mr. Chairman.

The CHAIRMAN. Senator Gorton.

OPENING STATEMENT OF SENATOR GORTON

Senator GORTON. Thank you, Mr. Chairman.

I simply would like to add my congratulations to those of members who have spoken previously to Chairman Volcker on his renomination. It may raise some questions about his judgment that he accepted that renomination, but it is, I believe, our good fortune that he has done so.

It's obvious that no mechanical rules of conduct of the Federal Reserve Board and its control of monetary supply can be applied with mechanical results. That means that we are in a situation in which the judgment of the Chairman and of the other members of the Board are virtually of paramount importance not only to the direct policy of the Board but to the economy of the United States itself. In that judgment, on the part of the Chairman, I have a great deal of confidence and I look forward to his own testimony here this morning.

The CHAIRMAN. Thank you.

Senator Dixon.

OPENING STATEMENT OF SENATOR DIXON

Senator DIXON. Mr. Chairman, I will not take the time of the committee for a long opening statement. I simply want to make a few brief points.

First, I support the reappointment of Paul Volcker as Chairman of the Federal Reserve Board. I was pleased to say so at some length on the Senate floor on June 9, so I won't repeat my reasons here today except to say that I believe that Chairman Volcker has conducted himself admirably while performing what is an impossible job, and that he's played an irreplaceable role in wringing inflation out of the American economy.

As I stated at that time, however, I have not always agreed with Federal Reserve Board policy decisions. I want to state in the strongest possible terms that I disagree with, dislike, and would oppose the rumored change in the monetary policy. In fact, I cannot conceive of how tightening the monetary supply and driving up interest rates which are already too high would be good for the health of the American economy. I have been reading a lot about how the recovery is so strong that it may be too strong and reignite inflationary pressures. All I can say is that whoever has been making those statements has not been to my State of Illinois or to other States in our industrial heartland.

In Illinois, unemployment did not fall last month, Mr. Chairman. It rose by four-tenths of 1 percent to 12.4 percent. Ordinary people in my State are hurting and I simply don't see how increasing the discount rate, tightening the money supply, and driving up interest rates on homes, autos, and consumer purchases will help them at all. We don't need the recovery dampened in Illinois, Mr. Chairman. We are already drowning. What we need is a strong, vigorous, sustained recovery, a recovery that has yet to reach Illinois.

The CHAIRMAN. Senator Mattingly.

OPENING STATEMENT OF SENATOR MATTINGLY

Senator MATTINGLY. I won't take up too much of your time. I'm sure that you're going to be confirmed and most of us will support your nomination.

I think it's interesting to see the great debate that we will have over monetary policy with which Congress has so little control over. I wish Congress spent as much time with fiscal policy. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sasser.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you, Mr. Chairman.

Chairman Volcker, I wish to extend to you my congratulations on your reappointment. The last time you came before this body for confirmation the vote was 98 to 0, an impressive vote for confirmation, and I might say that I voted for your confirmation at that time also. But I would have to say to you today, Mr. Chairman, that the vote will not be unanimous this time. I, for one, intend to vote against your confirmation.

I would cast my vote against your reappointment as Chairman of the Federal Reserve Board because I believe the monetary policy followed by the Federal Reserve Board since October 1979 has stymied the economic growth of this country and seriously damaged our economy. Our current economic problems can be traced in considerable measure to the high interest rate policies of the Federal Reserve.

Unemployment still stands at 10 percent in this country. Eleven million Americans are unemployed. During 1982, the Congressional Budget Office has estimated that some 28 million people were unemployed at one point during the year.

On the business front, business failures have reached record highs and business profits also record lows. More than 17,000 businesses failed according to Dun & Bradstreet in 1981; 25,000 closed their doors in 1982. And the failure rate this year could push the 30,000 level mark. Corporate profits have taken a severe nosedive and corporate profits after taxes are estimated to be $113 billion in 1983, $52 billion less than they were in 1979. High interest rates have adversely affected our balance of trade. Our exports are priced out of the world markets and cheaper priced imports continue to flood our domestic markets, putting even more of our people out of work. By some estimates, our trade deficit this year might hit the $70 billion mark.

But the cruelest indictment of the monetary policy that's been pursued can be found in our record of no economic growth since 1979. High interest rate policies have stopped economic growth in its tracks and I would say to you, Mr. Chairman, that as Chairman of the Federal Reserve Board you must bear considerable responsibility—and there's plenty of responsibility to go around, plenty of blame—but you must bear considerable responsibility for the dismal performance of the economy over the past several years.

And I say to you, Mr. Chairman, that I do not opppose your renomination on personal grounds. Your integrity is above reproach. You have conducted your responsibilities with a strong conviction and a clear conscience. You are a man I think of substantial intellect. You are an exemplary public servant. You have accepted renomination to this job at a time when I think you're perhaps at the crest of your prestige and prominence in the financial community and you could have bettered yourself substantially financially by going into the private sector, and I can only think that you continue to serve because you feel you can make a contribution to your country. So my vote will not be based on personal reasons.

The issue is much larger than that. The vote should be based on your record in conducting monetary policy that helps produce the best economy for our country. In that regard, Mr. Chairman, I judge the Federal Reserve Board's policies over the past few years to have been seriously flawed.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hecht.

OPENING STATEMENT OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman.

Mr. Volcker, this morning we have all had good laughs, but as a former businessman struggling through the worst economic times and the highest interest rates, since the depression, I'm quite anxious to hear of your plans on monetary policy on the continuation of your term. I hope that you will address these plans.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Lautenberg.

OPENING STATEMENT OF SENATOR LAUTENBERG

Senator LAUTENBERG. Thank you, Mr. Chairman.

I'd like to say at the outset that Chairman Volcker, in addition to his very considerable experience and expertise in financial policy, has a special qualification that should not go unremarked. He is a native son of New Jersey. He was born in Cape May, grew up in Teaneck, and has been a resident for several years of my own home city of Montclair, N.J.

So, Mr. Chairman, to paraphrase the poet William Proxmire, I say, "I came not to bury Volcker, but to praise him."

In addition to those wonderful attributes, Paul Volcker's record of public service is at the highest level of professionalism and integrity and it precludes any need for an extensive introduction. I welcome him here from this New Jersey corner.

Mr. Chairman, Chairman Volcker, I have to say that I am concerned that the President might be putting you in a bind with respect to monetary policy and interest rates. Everyone knows we are going to have record deficits this year and out into the future unless we are willing to do something about fiscal policy. The budget resolution passed by the Congress this year still leaves a glaring deficit, but it's a step in the direction of whittling it down. However, the President refuses to have anything to do with this process. In fact, he has threatened to thwart a more responsible fiscal policy by a string of vetoes. This puts enormous pressure on the Fed as the only part of the government able to take action.

Mr. Chairman, I believe the President is trying to have it both ways. On the one hand, he is urging the Fed to hold down the money supply. But he says he does not want the Fed to raise interest rates. Further, he is unwilling to cooperate with the Congress to hold down deficits. The fact is, the last administration's deficits look insignificant compared to what we have now.

The Fed's instruments are blunt. If the President tries to pass the buck to the Fed—and refuses to take responsibility for mounting deficits—there is only one thing the Fed can do. It will take action to drive up interest rates. Higher interest rates will choke off the recovery we have and, Mr. Chairman, we just can't have that.

While national statistics seem to indicate an improvement in the economy, I have to tell you that the situation in our State is actually deteriorating further. The unemployment rate in New Jersey shot up from 6.8 percent in May to 8.4 percent in June. This means that the number of people looking for work in our State has risen in a single month by over 60,000. The total number of unemployed in New Jersey now stands at 305,000. That probably underestimates the real situation by not including those people off the unemployment rolls or discouraged workers.

Mr. Chairman, I welcome you. I congratulate you on a job well done and I hope to discuss further matters with you when we get to questions.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Lautenberg.

Senator Trible.

OPENING STATEMENT OF SENATOR TRIBLE

Senator TRIBLE. Thank you, Mr. Chairman.

I would join my colleagues in welcoming you here today. You are to be congratulated for the job you have done over the last 4 years. The time has come for us to hear from you today, so I will spare the committee an opening statement.

But I do want to add just a personal note and say that it is the opinion of this Senator that you have done a good job and you have earned my confidence and support and best wishes.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. I have no statement, Mr. Chairman.

The CHAIRMAN. Senator Hawkins.

OPENING STATEMENT OF SENATOR HAWKINS

Senator HAWKINS. Mr. Volcker, I welcome you here today and I'm looking forward to the answers to some of the questions I have since we last spoke. Thank you.

The CHAIRMAN. Senator Cranston could not be here today but has requested his statement on the nomination of Mr. Volcker be included in the record.

STATEMENT OF SENATOR ALAN CRANSTON ON THE NOMINATION OF PAUL A. VOLCKER TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Senator CRANSTON. Mr. Chairman, I will vote against reporting the nomination of Paul Volcker to be Chairman of the Board of Governors of the Federal Reserve to the Senate.

I do so not because I have any personal objection to Mr. Volcker. I think he is a capable, knowledgeable, intelligent, and dedicated public servant.

But he is the architect and symbol of a cold, cruel, and callous economic policy. I do not support that policy. It has deliberately produced recession and high unemployment, bankruptcies, and foreclosures and has broken the fair expectations of working men and women, business people, farmers, and home owners, that they should have a reasonable opportunity to earn a decent living and lead a dignified life.

I will vote therefore against his nomination.

Monetary policy today is coming under increasing criticism even from those who serve as apologists for an overall approach to the economy that primarily works for the benefit of the very wealthy.

Monetary restraints have helped produce what may be only a temporary end to inflation. Other factors—the world oil glut and bountiful crops—have contributed to the present suppression of inflation.

Monetary restraints and escalating interest rates have proved mainly successful only in blunting economic recovery. They are only part of what is needed to restore our economy to full productivity and full employment without inflation and without high interest rates—goals to which I am irrevocably committed.

Extreme reliance on monetary policy has exacted too high a price from too many innocent bystanders. I know we need a sound, balanced monetary policy without unrestrained growth in the money supply—but the Fed under Mr. Volcker has been too extreme. And we must not rely on the Fed alone.

The other instrumentalities of the harsh economic policies our Nation has been pursuing for the past few years are the Reagan administration and a compliant Congress.

Congress itself has yielded to the Federal Reserve enormous powers—by default.

Today the newspapers report a major surge upward in the prices of stocks.

Why? Because Paul Volcker suggested that the Fed might be flexible in providing credit to the financial system.

With the raise of his eyebrows, the markets rise and fall 30 points. That's astounding. My colleagues should consider why that

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is and what our own responsibility is for restoring strength and fairness to our Nation's economy.

PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

The CHAIRMAN. Mr. Chairman, before we start, may I have you rise and be sworn in, please?

[Whereupon, the witness was duly sworn.]

The CHAIRMAN. Especially with the number of Senators we have in attendance today, we will hold closely to the 10-minute rule. Someone suggested even 5, but that makes it difficult to develop a line of questioning. We will have 10 minutes but I would hope each of you as you receive your notes, would stop within that period, and we will stay as long as any of the members of the committee wish to ask questions.

Before I ask my first question I would like to make one more comment. A great deal has been said about the effect of monetary policy on interest rates. My good friend from New Jersey has made comments about the President's responsibility for deficits and I would only like to make one factual comment on deficits, and it is a factual comment because the Constitution makes it so. Only the Congress of the United States has the ability to appropriate money. No President or any Federal Reserve Chairman has ever spent a dime not appropriated by Congress, not George Washington, not Abraham Lincoln, not Ronald Reagan. The President can recommend a budget and he can certainly twist arms to get it passed. He has the ability to veto, but ultimately a President does not spend any money that was not appropriated by Congress. So I must stress what I said in my opening remarks, if we don't like $200 billion deficits, if we do not like $125 billion of interest on the national debt, if we don't like $1.4 trillion national debt, then it seems to me, rather than looking at the Chairman of the Federal Reserve or this President or any other President, we are the only ones under the Constitution of the United States who have the ability to change the deficit figures, and when Congress comes to grips with the $200 billion deficits and casts the tough votes to reduce them, then we will start to see some improvement in this economy and make the job of the Federal Reserve much easier.

Senator SARBANES. Mr. Chairman, would you yield on that point?

The CHAIRMAN. Yes; I would be happy to yield.

Senator SARBANES. As I understood your statement, it was that neither the President nor the Federal Reserve can spend any money unless it's appropriated, and I think that's correct with respect to the President. But my understanding is that the Federal Reserve spends about $1 billion a year that is not appropriated, that does not go through congressional review or congressional scrutiny, and is not submitted to the Congress.

If I'm in error about that, I would like to be corrected.

The CHAIRMAN. Well, the Senator is technically correct, but the remainder of that statement should then be that the Fed also returns a profit of over $14 billion a year to the general fund, reducing the deficits. I know of no other Federal agency who does that, who helps reduce the deficit. That was not the intent of the Federal Reserve. I think it clouds the purpose of the Federal Reserve. They were intended to be an independent agency being self-operating from their own funds generated, but they have gone far beyond that and produced a very sizable profit for the general fund of the Treasury each year.

Senator SARBANES. But they do spend money without it being appropriated.

The CHAIRMAN. That is correct, but it certainly is correct that no President has ever spent a dime that this Congress did not approve and cannot.

Mr. Chairman, will you agree to avoid all conflicts of interest or even the appearance of such conflicts in your service as Chairman of the Federal Reserve Board?

Mr. VOLCKER. Yes, sir.

The CHAIRMAN. Will you agree to appear before this committee and other duly constituted committees of the House or Senate when you're requested?

Mr. VOLCKER. Yes, sir.

The CHAIRMAN. Chairman Volcker, while next week's Humphrey-Hawkins hearings will be the proper forum for you to discuss the intended course of monetary policy over the next 12 months, is there anything you would like to say on that subject this morning in general? We will be questioning you specifically next week, as I said in my opening remarks, and let me just say for those members of the committee who were not here during my opening remarks that because of the timing of these two hearings and the Federal Open Market Committee meeting and completing their meetings only yesterday, I do not intend to have the committee vote on the nomination of Mr. Volcker until after we have completed the Humphrey-Hawkins hearings next week so that you will be able to question him more specifically on monetary targets for the next year.

Mr. VOLCKER. May I say first, Mr. Chairman, that I appreciate your comments and those of your colleagues, as well as your personal support and that of others. I also appreciate your concerns, and I think I understand some of your warnings, personal and otherwise.

In approaching the general question that you asked, let me say that we all face the job of getting the economy on a sustainable, noninflationary path. I have always felt, as you well know, that getting the economy on a sustainable growth path goes hand in hand with the necessity for financial stability and a noninflationary path.

In the most general terms, it's the job of the Federal Reserve, and the job of all of us, to take the actions that are necessary to achieve that. Some of the comments that have already been made make it quite clear that the Federal Reserve is only one actor in that drama. We are not going to do the job alone, but we do have a large role to play. When we try to map out and conduct monetary policy, we have in mind a basic objective of achieving growth in the economy and sustaining that growth in a context of financial stability. Those basic, continuing goals motivate the tactics and strategy of monetary policy in the short run and over time.

That involves, constantly, the need to balance today's actions against their consequences, taking the total environment in which we have to operate over a period of time. That's as true today as it has been at other times, perhaps particularly true today.

IMPACT OF INCREASE IN INTEREST RATES

The CHAIRMAN. Mr. Chairman, a great deal is said about what would happen to the economy if interest rates go up and also about the ability of the Fed to control those rates.

Would you describe for us in some detail what your ability is—as a matter of fact, I was asked this morning if I was going to demand of you that you hold mortgage interest rates below 13.5 percent. What is the ability of the Federal Reserve to control mortgage rates, auto loan rates, bond rates?

Mr. VOLCKER. Obviously, we have some influence and can have some influence on interest rates, particularly short-term rates in the short run. But nobody can control rates in any narrow pattern regardless of what's going on in the economy generally. If you have a high rate of inflation, if there are strong fears of rising rates of inflation, if you have tremendous demands in the credit markets from Government or elsewhere, there's nothing we can do over a period of time to keep interest rates down.

Under other conditions—if there were confidence about the inflation outlook, with Government deficits under control—there's nothing the Federal Reserve could do to hold interest rates up over a period of time, so our influence in a direct sense seems to me a short-run influence.

In a more profound and meaningful sense, our influence over interest rates over time depends upon what contribution we can make to the inflationary problem and to the sustainability of growth. If our actions today can contribute to that result next year and the years following, then we will have a favorable environment for interest rates. If they do not do that today, we are left with an inflationary situation in the future, and we are not going to have a good environment for interest rates and nobody could give you any assurance that interest rates could be held down.

The CHAIRMAN. Well, your answer is simply, then, I believe, that there needs to be better coordination between monetary and fiscal policy.

Mr. VOLCKER. There needs to be that; not just that, but that's an important element. My answer is we are only one actor in the total drama and our influence is more profound over time indirectly, if you will, than in its immediate impact on the market in terms of what open market operations did in any given week.

The CHAIRMAN. And specifically, whatever impact you do have on interest rates would be more on the line of short-term interest rates and not in the mortgage rates over a long period of time?

Mr. VOLCKER. Yes; that is unquestionably true.

The CHAIRMAN. So when we're looking at mortgage rates, I assume the primary responsibility in that area would be that of fiscal policy and what we do here in Congress in attempting to reduce the outyear deficits?

Mr. VOLCKER. The U.S. Treasury is borrowing about $750 million on average each workday. That's a lot of money to be taking out of the market constantly and, obviously, that does compete with other demands for credit.

The CHAIRMAN. What is your estimate of the total amount during the remainder of this year—expressed as a percentage of net savings—that it will be necessary for the Federal Government to borrow to finance the deficit? In the last quarter of 1982 it exceeded 50 percent of all the available savings in the economy, which certainly makes much less available for the private sector. I've heard some estimates that we would reach in excess of 70 percent this year.

Mr. VOLCKER. I haven't got a precise figure in mind for the next few quarters. If one takes the net domestic savings potential of the economy—recently about 8 percent of the GNP—and you're running a deficit in the neighborhood of 6.5 percent—looking at the year as a whole this year—then your using over three-quarters of savings this year.

Now one consequence of the size of the deficit is that we are, appropriately or not, in some larger sense drawing upon the savings of the rest of the world to finance our own credit markets in very large volume. That's the other side of the coin that I think Senator Sasser and others mentioned; that is, the trade position, which has certainly been deteriorating very sharply. We are running into a large current account deficit. That is the other side of the coin of drawing on so many foreign savings to finance our own credit markets. You cannot draw upon the savings of the rest of the world without running a current account deficit, and that's what we're doing. It's useful to put it in that perspective because that is one of the consequences, one of the influences, that the Government deficit has. To the extent it adds to the total demands on credit and we draw savings from abroad, the result is a weak trading position.

OUTFLOW OF LOAN MONEY TO FOREIGN BORROWERS

The CHAIRMAN. That leads me to another question. This afternoon we will hear witnesses who charge that U.S. interest rates have been driven up because U.S. banks have loaned too much of the U.S. savings pool to foreign borrowers, going the other direction from what you just stated.

To what extent do you believe this has been responsible for the increase in U.S. interest rates in recent years, the outflow of loan money to other countries?

Mr. VOLCKER. I don't think it is having any particular influence currently. One can always argue that the less our banks or others lend abroad, the more we import capital, the better our credit markets would be. But, on balance, as I just indicated, we are importing large amounts of capital currently. That hasn't always been true; it was not true a few years ago. It is true now. I think it is true that in some areas we have been a large net capital exporter, but on balance we are currently a large net capital importer, and we have not been a large exporter, on balance, for some time.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator Proxmire.

SERVING A FULL 4-YEAR TERM DOUBTFUL

Senator PROXMIRE. Chairman Volcker, in my opening statement I took it for granted that you're going to stay the route; you're appointed for 4 years and you would be with us for 4 years. On the other hand, there's some indications this may not be the case.

For instance, the last time you were before the committee to be confirmed you indicated that you expected to serve out your full 4-year term. Now, however, I notice that in the personal statement filed with the committee you don't feel committed to serve out your full term and Time Magazine had an interesting observation on this. They said the following:

For one thing, he told presidential aides—

This is you—

That he believed the Federal Reserve Chairman's term normally 4 years should end at the same time as the President's. He said that the newly elected President should not concern himself with the Fed in the busy early days of his term but should terminate about 6 months afterwards even if it had been struck.

Was Time magazine accurate?

Mr. VOLCKER. I don't think entirely so. It is true, as I indicated in my statement, that realizing, among other things, that this is my second term and I have been here for a block of time already, I don't feel that I necessarily desire to commit myself by saying to you that I'm going to stay here for the four complete years for a variety of reasons.

But, I also understand that in undertaking the job I commit myself to stay a substantial length of time; I didn't want to absolutely promise that I would stay the full 4 years.

It's also true that in the past I, personally, and the Federal Reserve Board members have indicated that we would not oppose—and in varying degrees, I suppose, we support—the idea that if the Congress wanted to make a change in the timing of the appointment of a Federal Reserve Chairman—maybe there is no good time—the least worst time to do so might be a year or so after a presidential election to avoid the problem which can happen accidentally now; that is, of the job becoming open late in a Presidential term, perhaps in the midst of an election campaign and so forth.

Senator PROXMIRE. The trouble with this scenario, as I see it, is that this puts both the President of the United States and the Chairman of the Federal Reserve Board in a short-term perspective rather than a long-term perspective. I indicated that I thought we might be all right for a few months, maybe a year or maybe a little more, but that after that we are likely to be in very deep trouble.

The second part of that Time quotation—let me quote from that—"more important perhaps, Volcker made it clear in private talks—[quoting]—"that over the next 18 months he sees no reason to crack down hard on the money supply again. In his opinion, inflationary pressures have subsided enough so that the Fed can safely make enough money available to meet the borrowing needs of both business and government, given no gargantuan deficits, and keep the economy rolling."

Mr. VOLCKER. I don't recognize that part of the quotation at all, in terms of any conversations I've had. In appearing before this committee and elsewhere, as you well know, I have consistently expressed great concern about the possible conflict more than latent in the very large, persisting budgetary deficits during a period of economic expansion I have not fully shared, to say the least, the sense of relaxation perhaps that some have had that that would only be a problem several years down the road. When it becomes a problem depends partly on how fast the economy and, therefore, private credit demands expand.

As things now stand, as I think your own statement implied, we are in something of a potential Catch-22 situation. You've got the economic expansion, which is good, and you've got a fairly rapid expansion, which is good on the face of it, but it brings closer the day when you've got a potential conflict with the continuing large budgetary deficits.

Senator PROXMIRE. Chairman Volcker, there have been times in the past when the Fed has departed from its monetary targets during Presidential campaigns. The classic case that people think about was in 1972 when the Fed allowed an expansion in the money supply which many feel helped the election of President Nixon. There's a feeling around the country that this is the expectation in the campaign coming up.

Can you give this committee an unqualified pledge that your policies as Chairman will be governed solely by the needs of the economy regardless of how those policies affect the fortunes of either political party?

Mr. VOLCKER. Yes.

Senator PROXMIRE. Now last Tuesday the Federal Open Market Committee met to determine the course of monetary policy over the next couple weeks. What decisions were reached in that meeting?

Mr. VOLCKER. At the meeting yesterday or earlier?

Senator PROXMIRE. Last Tuesday. This is Thursday. That was a couple days ago.

Mr. VOLCKER. Tuesday and Wednesday. I think that falls within the terms of Chairman Garn's injunction, if I might say so. I would greatly prefer to address that matter specifically, in terms of the targets, in the regular hearings which come up next week. I don't think you will find those decisions terribly dramatic, but I don't think I should discuss them in specific terms now but rather lay them out carefully in a prepared statement as we normally do in that connection.

Senator PROXMIRE. Well, the reason I asked that is because by and large the Federal Reserve has not been forthcoming for weeks after the Federal Open Market Committee meets. Meanwhile, the big brokerage houses and the other big institutions have their experts at work and within hours after the Fed has met they seem to have a pretty good line on what's going to happen. The rest of the country doesn't know and it seems to me it puts at a disadvantage the rank and file people in this country and also the Congress for that matter.

Why shouldn't this be disclosed as soon as you're through? Why shouldn't we get the minutes the next day?

Mr. VOLCKER. Some times I think that would not be harmful. Other times it would be harmful. As a matter of general practice, I think it's necessary to retain some time period, because the market might over-react to what they interpret the words to mean when conditions may change within the month, something that's taken account of in the committee deliberations. I think you would get overreactions and misinterpretations more frequently than the reverse.

Senator PROXMIRE. Don't you get that even more so when you have all kinds of rumors and guesses and so forth by pretty high-powered people who are close to the Fed operation?

Mr. VOLCKER. There's a whole industry that devotes itself to trying to guess what the Fed is doing and the significance of our actions. You can pick up the paper any day and these presumably sophisticated interpretations are displayed for everyone to see, sometimes conflicting interpretations. But I do think that in ordinary circumstances, as a matter of routine, immediate publication would impair our attempt to convey the full flavor of a situation accurately without boxing ourselves in in terms of ability to react flexibly to what happens. We have taken that position, as you say, traditionally, and I think it's the appropriate position.

CONTINUED ECONOMIC GROWTH TO REDUCE UNEMPLOYMENT

Senator PROXMIRE. Let me ask a couple quick questions. The Democratic leader, Senator Byrd, asked us to ask you these questions. The first is, will you conduct monetary policy in such a way that the economic growth over the next couple years will be adequate to reduce unemployment significantly?

Mr. VOLCKER. Obviously, our aim is to have an economy in which unemployment is reduced and we are prosperous. I can answer that question, "of course, yes." If I may just say in that connection—and I'm repeating myself—what we are interested in is being able to say that through the years, in sustaining the advance. It's much more important that that condition be sustained than precisely what happens next month or next quarter or for a period of time.

Senator PROXMIRE. Along the line of sustaining it, is the current 6- or 7-percent growth rate so fast as to justify tightening monetary policy?

Mr. VOLCKER. We have had a preliminary estimate of 6.6 percent, I believe, in the second quarter. If I had to guess, I would think the final figures might show a higher rate of increase than that. An increase of that sort in this particular quarter of recovery is not itself a source of concern. We have an inventory change. It's very typical in this period of recovery that you have a big growth quarter; and, we start from a very low level. We have a long distance to go, so that kind of increase at this stage of the recovery is in itself not a source of concern.

We have to look at a variety of other indicators, as well as to what overall economic activity might be, for the sustainability of the recovery in the future, and that is related, of course, to the inflationary side of the coin.

Inflation at the moment is down. The last couple of months have shown a higher Consumer Price Index, but that comes after a string of very low, in fact, virtually no change in prices, for some months; there were some special factors in April and May. The inflationary trend, I think, is still favorable, but again, we have to look ahead and anticipate conditions that might change that in the future.

Senator PROXMIRE. My time is up, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you, Senator Proxmire.

Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

Chairman Volcker, this has proved to be an interesting hearing so far. You have been blamed for just about everything. You have been blamed for high interest rates. You have been blamed for this recession. You have been blamed for the international financial crisis.

The only two things I can think of that you haven't been blamed for are herpes and giving away the Panama Canal, but we're not through with the hearing yet. [Laughter.]

Chairman Volcker, almost everyone agrees that the 1981–82 recession resulted from high interest rates. A lot of people blame those high interest rates on you. Let me put it to you directly.

You became Chairman of the Fed in 1979. Did you and was it your intent to drive up interest rates; and if you did drive up interest rates, why did you do it?

Mr. VOLCKER. It was certainly not my intent to drive up interest rates to the degree that they rose. I did not have that in mind as my anticipation of what would happen. What we did have in mind was a feeling that the economy over a period of time would not prosper—we wouldn't have the kind of performance, we wouldn't have the kind of productivity, and we wouldn't have the kind of employment that we want—if that kind of serious, accelerating inflationary period were left unchecked. As part of any long-term program to restore the growth of the American economy you had to deal with that inflation problem as a matter of priority and, in dealing with that inflation problem, you ran into deeply entrenched expectations and behavior patterns. It was a difficult period, perhaps more difficult than I expected—and I wasn't a great optimist on that score.

Senator HEINZ. Are you saying that you had to increase interest rates to fight inflation?

Mr. VOLCKER. We had to restrain monetary and credit growth as the only tool within our control; and that, colliding with inflationary expectations, colliding with a number of other factors in the economy, including expectations, produced a high level of interest rates for a while. There's no question about that.

Senator HEINZ. In March of 1980 interest rates broke the 20 percent barrier, the prime rate as one indicator, for the first time in our history. Were you responsible for interest rates going over 20 percent?

Mr. VOLCKER. I think what was responsible for interest rates was the accumulating inflationary psychology and momentum in a fundamental sense. Those interest rates would have gone that high and they would be higher today if you had let the inflation continue. In that sense I would describe our policy over a period of time as just the opposite; we laid the groundwork for getting interest rates down and it was the only way, given the tools at our command, we were going to eventually get interest rates down.

Senator HEINZ. In March 1980 President Carter imposed credit controls on the economy. Did you favor or oppose those controls?

Mr. VOLCKER. We were not particularly happy about some aspects of those controls. He considered it very important as part of a total program. Some parts were quite acceptable to us in terms of what we call "voluntary restraints" on banks. Some aspects we had some concern about, but thought as part of the total program they were acceptable.

Senator HEINZ. It is generally viewed that in part as a result of the imposition of credit controls interest rates spiked up in March, April, and May 1980, then the Federal Reserve noticed there was an election coming in November and pushed the so-called magic button and brought interest rates down, and then after the election had to change course again and as a result interest rates went to 20 percent in December 1980.

Is that accurate; and if not, why not?

Mr. VOLCKER. It's not my interpretation of those particular events. After that period, when the money markets got quite tight and there were credit controls, there was a precipitous drop in the economy for about a quarter. It was very sharp and it didn't last very long. There was also a precipitous drop in the money supply for a period of a couple of months.

In retrospect, as part of time, it's apparent that those phenomena—the sharp drop in the economy and the money supply—were directly related partly to psychological effects of the credit control program. Interest rates dropped very sharply coinciding with a decline in the money supply when we were providing a lot of reserves to reverse the fall in the money supply. The money supply had begun rising, as I remember, by June, and accelerated during the fall. During that period we were progressively moving against the increase in the money supply and interest rates were rising from, as I remember it, late July or August right through the election period. It didn't make everybody entirely happy, but I would point out there was an increase in the discount rate in September.

INFLATION FIGHT BRINGS ON RECESSION

Senator HEINZ. So what you're saying is you started fighting inflation before the election?

Mr. VOLCKER. There's no question.

Senator HEINZ. Let me ask you about the inflationary expectations you mentioned. You said they were building up or they were high. What caused them to build up? What made them high? How long did that period of buildup take and what did they consist of, and what is different about it from today's economic climate?

Mr. VOLCKER. I think the explanation for that lies in all the postwar history, but particularly the period since the Vietnam war. We had maintained a reasonably good record on price stability through mid-1965; it was actually quite good and prices were effectively stable and we had a very nicely operating economy in the early 1960's. But progressively, after 1965, the inflation rate began moving higher. It was uneven and it came down during some recession periods, but it remained at higher levels during recession periods and reached new peaks during expansion periods right through the late 1970's. That situation was complicated, among other things, by the oil crisis. That's not entirely an independent event, in my judgment, but acceleration in energy prices was partly related to a feeling that inflation had taken hold in the United States and elsewhere and after 10 or 15 years of that trend people began to count on it. And, once they begin expecting it, once they begin managing their business affairs or personal affairs in the expectation of inflation, the thing begins accelerating and it doesn't help business activity. Any feeling that you get some stimulus to business out of the inflationary process goes away once people begin anticipating it, and they begin anticipating it even faster than it happens.

Senator HEINZ. To summarize what you're saying—and tell me if this is right or wrong—are you saying that the 1981-82 recession was inevitable, or if not inevitable, that the only other alternative would have been high inflation and interest rates to match?

Mr. VOLCKER. I'm not sure it was entirely inevitable—certainly in its severity—but it would have been inevitable to some degree. You can always go back and say if we had managed our affairs perfectly, with the benefit of hindsight—I'm not speaking now of the Federal Reserve in particular, but if all of governmental policy had been perfectly arranged—we could have dealt with this problem with less pain. Of course, that's not the real world.

Senator HEINZ. Let me phrase the question a little more precisely because you took over in 1979. At that point, not at 1973 or at 1971 when President Nixon put on wage and price controls, but in 1979, in your view, was a recession at this point inevitable? As you look back, is there any way we could have avoided it?

Mr. VOLCKER. As I look back, maybe so. I would have appreciated at that time that there was some substantial risk in the process of dealing with the entrenched inflation, particularly if other instruments of policy were not totally supportive, and they never are. I don't say that as great criticism, but in this particular case there was a very heavy burden on monetary policy itself, which increased the risks.

Senator HEINZ. Are you saying that Congress could have taken some action to avoid it?

Mr. VOLCKER. Public policy in general could take some action. The fiscal side is one dimension, but there are many other governmental policies that tend to keep the inflation process going. Some of those policies are very deeply entrenched, and you don't realistically expect them to be revolutionized in a short period of time, I suppose.

Senator HEINZ. I would agree with you on that. I remember a hearing that Bill Proxmire held in the Banking Committee where four or five previous Chairmen of the Council of Economic Advisers were called before this committee and they all advocated a list. It was remarkable. They were liberal Democrats, conservative Republicans, and they all advocated a list of initiatives almost to a man—accelerated depreciation, lowering the deficits, less regulatory interference in the economy, measures to improve productivity. It was significant to me that by the end of 1980 not a single one of those recommendations had ever been acted upon either by the Congress or by the White House.

Mr. VOLCKER. If I might add one point that I think is crucial in evaluating this situation, Mr. Chairman. We talked about the risk of recession and whether it was inevitable as part of getting rid of inflation. Let me say with all the conviction I can muster, if we had collectively let that inflation go ahead, eventually we would have had much more severe economic difficulties than in fact we have had. The quicker you can take care of these problems, the better off you are. That's the lesson you see in many countries around the world, including many developing countries today.

The CHAIRMAN. Senator Riegle, before I turn to you, let me make a procedural comment. It's my usual practice in the Committee to record the arrival of Senators and call on them in that order rather than on the basis of seniority and on each side. If any of you wish to make individual arrangements beyond that, if you have time constraints and want to talk to those Senators junior to you who would be called on first, that would be fine with me. Short of letting me know that, I will call on you on the basis of the time you arrived at the hearing.

Senator RIEGLE. Thank you, Mr. Chairman.

BUDGET AND TRADE MOST IMPORTANT TO ECONOMIC RECOVERY

It's very hard in a 10-minute period or even in this whole session to get right down to the things that perhaps we should most try to talk about and to illuminate, but let me try to get to what I think is the central concern that I have. I'm just asking you to use your best professional judgment now.

If you take the major elements of our economic policy mix as they exist today, the momentum that we have had and the track of monetary policy which of course you're intimately involved with, but also the fiscal trendlines that you see, the international trade picture which you're also well aware of and the international financial debt problems and some of the other financial structure problems, I'm wondering when you put the whole economic puzzle together today whether it is your feeling today that if we just stay on our current trendlines in those major policy segments, if all of that working together is going to sort of bring us right on through with a nice, sustained recovery with the things that we're looking for, namely, a low inflation rate, moderate interest rates, reducing unemployment levels and so forth.

The reason I want to try to frame it that way is that as I try to do that and as we all try to do that and especially in light of the dramatically changed world economic picture even in the last 5 years—it's just transformed itself—I have the feeling that we are *not going* to get all of the nice outcomes we would like to see unless further major policy adjustments are made on the margin. Fiscal policy is one that's been mentioned here, but I think trade policy, for example, ranks right up with it simply because the numbers and the job and economic strength consequences are rising to the size that I think make that now self-evident.

But what I'm concerned about is this. So much of the discussion here is whether monetary policy is one element on the margin, it can or cannot have that much effect in the overall outcome of things. Clearly it can have some effect and you, yourself, have said that today. But I'm wondering if it's your view that other major policy changes are going to have to be made here out over the next year or two in these other areas in order for this whole thing to be able to work together.

Mr. VOLCKER. Let me approach answering that question by saying, first of all, as I've tried to emphasize in earlier appearances before you, that I think we have a lot of ingredients that can give us sustained noninflationary growth, but we don't have all the ingredients. We have gone a long way toward developing that base, and I think the performance of the economy recently is consistent with that vision. But if I had to rank the concerns that loom in my mind as posing the risk, where changes are needed, I would continue to put the budgetary problem first on the list. That becomes more urgent, as I said before, the faster the economy recovers. That is not unrelated, as I said earlier, to some of the trade problems that you have emphasized because of the way that works in the financial markets, the effects it has on the exchange rate, on the flow of capital and through that mechanism on the trade picture.

Senator RIEGLE. Let me then ask you this more focused question. If the fiscal policy is going to remain loose, as it is I think today, with deficits running above $200 billion out over say the next 3 or 4 years, is that a condition in your mind that is so destabilizing as one of the major policy elements here that it in fact does leave monetary policy in an impossible position? In other words, I think you have to at this point, both in terms of the experience we have been through and the fact that this is a reconfirmation hearing—I think you've got to speak in very plain language if you feel that deficits above $200 billion are unworkable and could precipitate an undoing of the struggling of what we have been trying to do. I think you have to say so in very plain language publicly to this committee, to Casper Weinberger and everybody else. And if we're not going to say that and tiptoe around that and finesse that issue, then I think we are leading ourselves down the road that Senator Proxmire was talking about before, and that is that we are postponing a day of reckoning that's going to hit us like a ton of bricks, and I don't think any of us want that.

So if the deficits are going to remain above $200 billion, does that leave us with an unworkable policy mix in your judgment?

Mr. VOLCKER. "Unworkable," I suppose, is a matter of degree, but I don't want any ambiguity about the fact that I think that is a major risk that might disrupt what I think could be a very satisfactory—more than satisfactory—performance with very favorable long-term consequences.

When I look at the risk to that, the complications to that, the deficits stand out clearly as No. 1, and I don't see how you can expect equitable financial markets and rapid economic growth with those kinds of deficits.

Senator RIEGLE. Well, I think, then, you may have another aspect in your job that is growing here. That is, everybody is jawboning you. The President is jawboning you. You're getting a certain amount of it today. I think on this issue because you're positioned where you are you may have to do more jawboning on that and in other areas like spending, including defense spending. In other words, if the risk is high of deficits of $200 billion throwing this whole thing out of bounds so nobody can correct it, then I think we are going to have to hear much, much blunter comment about it. I hope that took place in the meeting with the President. I don't know whether it did or not. You may or may not want to comment about that. But it seems to me the risks we are running here are enormous.

Mr. VOLCKER. I agree with that. However, just to repeat, I think a lot of the groundwork has been laid for a much more favorable economic performance, and I think we are seeing some of that. That in no way diminishes that risk.

IMPROVEMENT IN HOUSING AND EMPLOYMENT

Senator RIEGLE. Let me just quickly jump to the housing issue. I was out in Michigan over the weekend. I talked to a number of builders. We've got a tough market situation out there anyway with unemployment still at 15 percent, but they tell me the recent uptake in interest rates which we have seen in FHA upward revisions and so forth have pretty much shut down the housing recovery there, and I'm getting signals that way from other parts of the country as well.

Is that what you're hearing, and what would be your feeling about what level of concern you would have if the housing recovery were to start to stop here simply because interest rates for mortgages are starting to move back out of range?

Mr. VOLCKER. Housing has done very well in the last 6 months, as you know. I do not have the kind of reports that you do, but I certainly think that housing is and remains a very vulnerable sector in terms of any prolonged or sizable interest rate increases there might be. That comes back, of course, in considerable part, to the budgetary problem.

Senator RIEGLE. Unemployment today, how serious a problem do you see that as being in the country? How much progress do you think we have made on it and how heavily does the concern about unemployment sort of weigh into the Fed policy discussions and decisions here?

Mr. VOLCKER. It weighs very heavily. We obviously have a historically high level of unemployment; whether it's historically high or not, it's much too high. We have had, in recent months, very sizable increases in employment. We have begun to see the unemployment rate go down, but it's going to take some time for that unemployment rate to go down to anything like the level you or I would consider satisfactory. Again, the job is to get that unemployment rate down in a way that it will stay down, not to get it down for the rest of this year and then run into another roadblock, but to get on a pattern where it can continue to come down and then stay at a more reasonable level.

Senator RIEGLE. I'll come back to that in the next round. I want to just move to the international debt situation. We are hearing a lot about Brazil now perhaps coming to the judgment or being unable to respond to its repayment requirements here that are upon it. How serious is that situation and then, of course, I'd like to drop back to the other countries that are in the greatest difficulty.

Mr. VOLCKER. The problem is serious in Brazil and it's amplified because it's part of a much larger problem of developing countries in Latin America and elsewhere. I would note that just today Brazil is taking some very strong actions to deal with its problems, and I feel quite optimistic about that situation now because I think there are indications they are facing up to very tough problems in that country and have begun to take the kind of forceful actions that are necessary to lay a base for the necessary confidence in financial markets and in the rest of the world outside of Brazil. That problem, with the cooperation of a lot of people, can be managed.

Senator RIEGLE. My time has expired. I will come back to these things in a later round.

The CHAIRMAN. Senator D'Amato.

Senator D'AMATO. Thank you very much, Mr. Chairman.

Chairman Volcker, it seems to me we are in a catch-22 position in that we constantly hear the theme that deficits are creating this great problem.

It seems evident to me that one way to ease the growth of deficits is through a strong, sustained economic recovery, assisted with lower interest rates which would enhance our revenue base and reduce our interest payments on our monumental national debt. Without that economic recovery, and consequent large-scale unemployment, those deficits are going to continue to be unacceptably high.

However, if we do not maintain interest rates at acceptable levels, basically the levels that we have today or maybe even lower, it is doubtful that we are going to have a sustained economic recovery. I think that is the real catch-22 that in which we find ourselves. It is not good to have people just preaching about the size of the deficit. Congress certainly has a primary responsibility here, but by reducing unemployment, by creating a situation where business and industry are paying taxes and people are paying taxes and the revenue scene is enhanced should we not see an easing of our deficits?

QUESTIONS ON SUSTAINABILITY OF RECOVERY

Mr. VOLCKER. Yes. You've got to judge the significance of the deficit in terms of performance of the economy. There's no doubt that if the economy is in recession or sluggish the deficit is going to be bigger, but it's not that part of the deficit that we worry so much about. There's going to be a big deficit even as the economy recovers—unless something is done about it—and it's that part that remains after the economy recovers that's a source of the difficulty. You're still left with a deficit, let's say, in the range of $100 billion with full recovery. You have a deficit running 2.5 percent of GNP, maybe more, in a condition of prosperity and full employment. This implies that the Federal Government is going to be preempting a share of the credit flows without any precedent during a recovery period. It's inconsistent—and that's the catch-22 part, I suppose—with the kind of credit demands that come from the private economy with the assumption of a prosperous, growing, fully employed private economy. That's the problem, and it remains a problem, let's say, in the $100 billion magnitude. That's the current situation of the deficit. Part of that will be taken care of by growth, but the problem is not all of that is going to be taken care of by growth.

Senator D'AMATO. In light of the low rate of inflation, why is the real rate of interest still as high as it is, and would you give us some historical perspective on that?

Mr. VOLCKER. The real rate of interest is, in a sense, impossible to measure. You're measuring the nominal interest rate against what people expect inflation will be. With respect to the long-term markets, while we have had an inflation rate for the last 12 months on the order of 3.5 percent using the Consumer Price Index, I don't think expectations of bond buyers or bond sellers or home buyers or home sellers are for an inflation rate to persist that low over a period of time; there's still a substantial feeling of uncertainty about what the risks are of inflation increasing.

That is one factor that makes the rate of interest high. And, of course, that is related in part to the posture of policy—monetary policy or fiscal policy—and what judgments people make as to those policies in the future. After going through a 15-year period of accelerating inflation, it takes more than 2 years of improvement to instill confidence that the trend has changed fully.

A lot of progress has been made in that direction and people don't feel nearly as concerned about inflation as they did a couple of years ago, but it's a matter of degree.

Another factor is—I'm sorry to keep coming back to the same issue—but Senator Riegle encourages me by saying that I don't make enough noise about it; that's not what everybody says—that you have this very large deficit which needs to be financed at levels that are without precedent and will continue high, given the current stance of policy, well into the period of recovery and beyond.

Senator D'AMATO. Again, Mr. Chairman, without a sustained recovery, there really is little hope of reducing that deficit appreciably, given the political realities in attempting to reduce our budget. I have heard the rhetoric for 2½ years. I hear people talking about how they are going to reduce deficits. The same people that are talking about reducing deficits are voting to increase every entitlement program.

So the question remains: Is this recovery too fragile at this point in time to have an increase in interest rates? Wouldn't that imperil that economic recovery?

Mr. VOLCKER. I would not judge the recovery at this particular point in time—and this is a short-term perspective—as particularly fragile. As you cast your mind forward into late 1983 and 1984, I think you can raise a lot of questions about the sustainability of recovery and certainly the kind of recovery we would like to see—housing, business investment and all the rest—at this or a higher level of interest rates. So I would make a distinction between the problems that potentially lie ahead, potentially and the vigor of the recovery at the moment, which seems to me quite substantial.

Senator D'AMATO. I believe that if we do get a substantial increase in those interest rates, we are going to see that housing recovery decline. We are going to see that the growth that we really need is not going to take place, and I think there are many people who fear this sequence of events.

As always, perception is very important as we dicussed yesterday. It just seems to me that the release of these M money figures on a weekly basis does not give any degree of reliability or continuity that people can count on. The fluctuations in the weekly releases help to exacerbate fear and uncertainty in the business community. Would not it be better to release such figures less frequently in order to diminish that effect?

Mr. VOLCKER. I place no confidence in M on a weekly basis.

Senator D'AMATO. Say that again.

Mr. VOLCKER. I've said this many times. The weekly M figures bounce up and down, and on a weekly basis they are meaningless. That's not quite the situation we have now. We do have weekly fluctuations obviously, but we have had very sizable growth in that particular figure for a period of 9 months, and that has been a source of some concern to some people. It's that pattern of growth over a period of months that should be the source of concern if it's a source of concern at all, not the weekly fluctuations.

PRESENT RECOVERY CALLED AVERAGE BY FED

Senator D'AMATO. Let me ask you this, Mr. Chairman. Given that the Federal Reserve has clearly taken an anti-inflation, slow growth money supply course, and I do not argue with that policy, what prospects do you see for interest rates in both the near term and long run?

Mr. VOLCKER. I have expressed this thought on many occasions. If we conduct ourselves appropriately, if we maintain the progress on inflation and disappoint some of those expectations that it's going to rise that I referred to earlier, the prospect—I'm almost tempted to say the inevitability under those conditions—is that interest rates are going to come down over a period of time.

I'm addressing the long run now. Again, a major complication in the short run and a complication for the long run as well—both directly and because many people find it incredible to think that inflation will come down if the deficits remain so large—is that deficit problem, which runs in the other direction and certainly complicates life now and potentially in the future.

Senator D'AMATO. I would like to add that I believe there is somewhat of an overemphasis on the inevitability that deficits will lead to inflation. Obviously, we cannot accept $200 billion deficits year after year. But, the private sector can play a major role in reducing those deficits through the benefits of sustained economic recovery.

Mr. VOLCKER. That's what we're racing to a degree now. Let me say that I don't think those deficits make inflation inevitable by any means, but if they persist, it's going to force the economy into the kind of contortions you wouldn't like and I wouldn't like. It

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could impact on housing. It's going to impact on business investment. You may be able to keep inflation down, but you're going to lead to a very unbalanced recovery. That's the optimistic view, and it's not very satisfactory. It doesn't bode well for the sustainability of the private growth and it doesn't bode well for continued growth in productivity and a lot of other things. I don't think it's inevitable that the deficit means inflation, but it certainly puts pressure on financial markets and it puts pressure on us in a very direct sense.

Senator D'AMATO. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Dixon.

Senator DIXON. Mr. Chairman, there's a remarkable type of information flowing from the hill here and I think being disseminated by the news media and the country now that the economy may be improving at such a rapid rate that something ought to be done to dampen this improvement. That certainly is not the response I get when I go back home to my State and I would like to ask you, first of all, are you or the folks at the Fed now contemplating any increases in the discount rate or any marked tightening of the money supply?

Mr. VOLCKER. I don't think it's appropriate for me to comment specifically on the discount rate question.

In terms of the general posture of policy, it's fair to say that it's rather obvious we haven't taken any very drastic or strong actions in recent weeks. But it is also true that you could characterize policy in the last month or two as being slightly less accommodative to large growth in money or liquidity than it has been earlier.

When one evaluates the business scene, as I said earlier, there's obviously nothing the matter with the economy expanding and there's nothing fearsome in itself about the growth in the second quarter or the growth you see immediately ahead. But you also have to look at the implications of what's happening on the financial side and with liquidity for the sustainability of the economy over a period of time. M_1 growth on the face of it has been quite rapid, but that I think involves a lot of uncertainties about what the trend in M_1 should be in a new institutional environment with lower levels of interest rates, with payment of interest on transactions accounts M_1 that we didn't have historically; we haven't put so much weight on that for some months, as we've indicated.

But if you look at the total picture in recent months, against the background of economic growth, we have had, not an alarmingly rapid growth, but growth on the rapid side in liquidity and money, however defined.

Senator DIXON. Now some economic advisers in the country suggest that we have had a strong economic growth recently. Others say it's average. How would you characterize it in the last few months?

Mr. VOLCKER. I can give you the results of a statistical exercise. If you average past recoveries, put monthly figures for this recovery against that, it falls right about in the average.

Senator DIXON. An average recovery. Well, an average recovery, in your view, would not call for any drastic response from the Fed; would that be a fair interpretation of what you have said here?

Mr. VOLCKER. Not in itself, that's right.

Senator DIXON. I just want to point out, Mr. Chairman, that as I said in my opening remarks, unemployment in Illinois is 12.4 percent right now. The unemployment figures have gone up. We have 102 counties in our State. Of those 102 counties, 89 have unemployment figures larger than the national average. The chairman was talking a moment ago about having you back here shortly under the provisions of the Humphrey-Hawkins legislation passed by the Congress. I think that called for an unemployment target range of about 5 percent. Certainly the country doesn't have that kind of experience and, quite obviously, for many of us in the industrial heartland the unemployment rate is quite a bit higher and I would suggest that, given those circumstances, that drastic responses at the Fed are not called for right now.

CONGRESS SHOULD CUT SPENDING AND INCREASE REVENUES

Mr. VOLCKER. Anything that I would think of as drastic is not going on at the moment. But let me say that the policy problem again—and I know I'm repeating myself—is always trying to look ahead, as best we can to see how to sustain this recovery, and that gets involved in the inflationary problem.

We have had a good inflation performance relative to what we had before; we have had moderation in prices and wages. A test remains ahead, as the economy expands, as to whether those moderate attitudes will remain in place. I think it's critically important, whether one looks at it from the standpoint of business pricing or the wage negotiation process, that people do have, first of all, confidence that inflation will remain under control, that they conduct themselves accordingly, as best we can encourage them to do so with concern over their competitive position, in part through the conduct of monetary policy. That, in the end, will be an immense contribution in sustaining recovery and dealing with that unemployment problem that you're rightly concerned about.

It's absolutely critical that those attitudes remain conservative or moderate, if those are the right words.

Senator DIXON. Getting back to monetary growth, Mr. Chairman, M_1 increased at approximately a 13.3-percent rate during the first 4 months of this year. During the last 4 weeks, however, M_1 has grown at a 7.7-percent annual rate.

Now does this decline in monetary supply growth rates signal that the Federal Reserve has already begun to tighten the monetary supply?

Mr. VOLCKER. I think that's too short a period to draw much conclusion from. Senator D'Amato was referring to weekly figures. You have expanded it to a few weeks. That's still too short a period on which to make any reliable judgment.

As I indicated, we have been what I would term as slightly less accommodative in recent weeks, but I wouldn't expect to see any quick reflection of that necessarily.

Senator DIXON. Of course, what concerns me there is the targets you suggested to the committee last year or the beginning of this year were 4 to 8 percent monetary growth in M_1.

Mr. VOLCKER. Yes.

Senator DIXON. You had it up to 13.3 percent for 4 months. You dropped it now to 7.7. What concerns me and I'm sure others is if you tried to conform to your original targets you would have to drastically reduce further those monetary growth targets and I'm afraid it could have a very adverse short-term impact on interest rates.

Mr. VOLCKER. Obviously, I will specifically discuss that next week, but I don't want to leave you hanging for a week.

Senator DIXON. Thank you.

Mr. VOLCKER. I don't think you should necessarily conclude that. Given all that has happened so far, given that we have said quite clearly that we have been a bit cautious about assessing what the appropriate trend in M_1 may be and have not given that full weight—as our actions have indicated and in our policy deliberations—that restoring that precise pattern of M_1 for the year as a whole isn't necessarily a high priority.

Senator DIXON. Very good.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Mr. Volcker, the top questions I had in my mind have already been answered. As a practical man, I do not wish to dwell in the past. I'm interested in the present and far more interested in the future. I plan to withhold my questions until you present your future plans next week. I hope at that time you would address what plans you have to prevent high interest rates again or perhaps you could address that question today.

Mr. VOLCKER. I will address at least one part of it. Maybe I unfairly read into your question the implication that the Federal Reserve alone has the tools to prevent high interest rates when other factors are moving strongly in the other direction. I do not believe that is true, so I'm not going to be able to tell you how the Federal Reserve all by itself can prevent the risk of higher interest rates.

I have indicated here and I think over a period of time that if we can maintain progress against inflation the interest rate trend is going to be in the other direction. It's going to be downward over time. We will do our best to create the conditions that make that possible, in the sense of what we would expect to happen if policies are successful, but I don't think you should be led to the thought that we have full control over that.

Senator HECHT. Well, continuing on, I have always heard that the mark of a great economist being great is to always reach for something unattainable. Now, you know, and I know, and everyone in this room knows that there is no way we can cut our budget $200 billion this year.

What can we do to stop interest rates from going higher and get some revenues back in? I have also been told that a 1-percent drop in unemployment will take $30 billion off the deficit. If interest rates rise, we are certainly not going to get these revenues in and we are going to have higher unemployment. Can you address that?

Mr. VOLCKER. What you can do in my terms is quite simple. It may be hard for you to do. You can come back here after you recess and do some spending cutting and revenue increasing looking toward 1984 and 1985 and get that enacted and provide a great deal of reassurance to the markets, both about the direct impact of

Treasury financing on the financial markets and on the outlook for inflation.

Now you don't have to do it by $200 billion. They would be satisfied under those terms with something considerably less, and the rest of the deficit would go away from economic growth, as you suggested.

Senator HECHT. As you just mentioned, you advocate higher taxes?

Mr. VOLCKER. I would prefer, if you can do it, that you do it on the spending side. I think that would be desirable in economic terms.

You may have other priorities, national and personal security. I can't tell you the answer to that. I will tell you, in economic terms, I'd love to see you do it on the spending side.

To the extent you can't do it on the spending side, I can't rule out revenue increases because I think the deficit is a matter of great priority.

Senator HECHT. What is the threshold for a deficit decrease that would prompt a drop in rates?

Mr. VOLCKER. I don't know whether I want to give you a specific number. Try $50 billion as a first step. [Laughter.]

Senator HECHT. Like I said before, an economist searches for the unattainable.

Mr. VOLCKER. I understand your skepticism or concern, but all I would say is, don't, as a Senator, expect the unattainable from the Federal Reserve.

Senator HECHT. How can we work together?

Mr. VOLCKER. I think that's a relevant question.

Senator HECHT. What's the answer?

Mr. VOLCKER. It sounds very self-serving for me to say I think we are doing our best and I'd like to see some action on the budgetary side.

Senator HECHT. Well, I'll wait to hear from you more next week.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Mr. Chairman, I'm going to defer to my colleague, Senator Lautenberg, who preceded me here.

Senator LAUTENBERG. That's the precedence of this day only.

The CHAIRMAN. Did I goof?

Senator LAUTENBERG. A little bit, but not seriously. I wanted to talk to you about that.

The CHAIRMAN. Well, I appreciate Senator Sasser's honesty.

Senator LAUTENBERG. Thank you, I, too.

CONTINUED RECOVERY AND HIGH DEFICITS

In response to my opening comments, my distinguished chairman reminded me that spending was the province essentially of the Congress and though one editorial the policy doesn't make, I did read the statement that appeared a couple days ago that obviously the budget is out of balance not because the Congress ignored the President's wishes but because of voting for both defense increases and tax cuts that followed them. Now I'll go on, if I may, to some questions I have for Chairman Volcker.

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

If you had a sense of de ja vue, Mr. Chairman, you should. What I just read is a quote from a former member of this committee at your nomination hearing 4 years ago.

Not a whole lot has changed except that the management of the Federal fiscal policy is now in much worse shape. In 1979, the deficit was $27.7 billion. This year, it will be above $200 billion, and under the President's budget, there will be another $500 billion in Federal red ink over the next 3 years.

Now you commented before about the relationship of the deficit to GNP and GNP growth. I'd like to ask you what your assessment is of the impact of deficits of this magnitude on the financial markets and the prospects for a sustainable recovery. Really, what choices will you have for action, assuming the recovery continues at this current rate and there is no serious effort to bring those outyear deficits under control?

Mr. VOLCKER. I think the most benign or optimistic view you could take of it, Senator, is that you would be squeezing the interest rate sensitive parts of the economy—housing, business investment, perhaps the automobile industry. The economy as a whole might continue to expand simply because the Government is putting out so much purchasing power, but it wouldn't be a very satisfactory expansion. Interest rates would be higher than otherwise, certainly, without predicting where they might be. It would diminish the chances of this longer term expectation that I described to Senator D'Amato. That would be the good news.

The bad news would be that in a volatile, uncertain expectational situation, you get still sharper reactions in financial markets that would clearly threaten and abort the recovery itself. You wouldn't have a balanced recovery; you would just threaten that the recovery would be prematurely curtailed.

You could take another course, I suppose, with the Federal Reserve somehow trying to accommodate that at the expense of inflation rising. I don't think that policy would work because that would only add to the threat of the second kind of scenario—concerned and frightened financial markets. You might be successful for a matter of months, but you couldn't be successful for very long in maintaining any kind of an equilibrium in the financial markets under those conditions.

Senator LAUTENBERG. You said you could do something about squeezing the senstive parts. How do you squeeze them?

Mr. VOLCKER. They would be squeezed by interest rates being higher than would otherwise be necessary.

Senator LAUTENBERG. But in order to get those interest rates higher, that would have to be an overt action on the part of the Fed?

Mr. VOLCKER. I don't know what you think of as overt action.

Senator LAUTENBERG. Curtailing the money supply, raising the discount rates.

Mr. VOLCKER. Either way, you're going to have a problem. If we maintained a fixed course—did not curtail the money supply but just maintained the money supply at a level that it would otherwise be—and you squeeze the Government financing into it, you're going to get a higher level of interest rates.

If you took the opposite course and said, we don't care what the increase in the money supply and the increase in liquidity will be and we'll accommodate it all, then you're certainly going to get inflation and get higher interest rates anyway, and get it still higher.

Senator LAUTENBERG. Let me ask you this. Have you discussed this problem with the President or his advisers, and, if so, did the subject come up in the context of your renomination?

Mr. VOLCKER. I don't think it's appropriate to discuss a particular conversation with the President, but my views on this matter are no secret to the administration.

Senator LAUTENBERG. All right. Let me extend the question. Have you agreed to play the bad guy and take the heat off for offsetting inflationary pressures that might come about as a result of our fiscal policy?

Mr. VOLCKER. Not explicitly.

Senator LAUTENBERG. How about implicitly?

Mr. VOLCKER. Implicitly, it depends upon what events prove to be. I can't be quite so pessimistic as Senator Proxmire.

Senator LAUTENBERG. There's been a reporting of a split in the administration concerning economic policy. The law firm of Regan, Feldstein and Stockman is apparently concerned about the combination of huge deficits and accelerating recovery, of monetary growth above the targets. This group would favor, as I read it, applying the brakes now.

The White House, though, discounts these concerns and sees the current pace of economic expansion as the solution to our problems.

How do you feel about the views of each of these factions, if I can call them that?

Mr. VOLCKER. I don't think I can comment on that. I may comment more generally. The comment that applies perhaps not particularly to the administration but to Congress and to a great many people looking at this problem is that there is a general concern about the deficits. It may be held more strongly by some than others, but it is quite general and pervasive.

The problem that you and others in politically responsible places have is balancing that concern against other priorities you have, whatever those priorities may be—whether for defense spending, for not raising taxes, for particular spending programs.

From my perspective, the difficulty is that the deficit problem deserves very high priority—in an economic policy sense, first priority—but sometimes gets submerged among these other problems. It's not that anybody welcomes the deficit and doesn't see it as a problem.

Senator LAUTENBERG. In response to an earlier question about what you might do about deficits, you said that you preferred spending curtailment first, but I think I did hear you say that revenue enhancement might follow if you've cut spending to the bone.

How would you enhance revenues, Mr. Volcker?

Mr. Volcker. You're asking me a question that's really beyond the area that I like to get into. I have enough problems of my own without suggesting precisely how you might go about it.

Senator Lautenberg. As a fellow resident of or former resident of the same town, we can talk privately here, and why don't you just give me your inside view?

Mr. Volcker. Let me give you a nice, general response. If you have to raise revenues to deal with the deficit problem—in light of what you can do on expenditures and recognizing that that side is preferable—I'd try to do the revenue side in a way that is most consistent with preserving and enhancing incentives for savings and the investment side of the economy. Those are very general guidelines, but I'd try to arrange it to the maximum extent possible that way.

Senator Lautenberg. Thank you.

Thank you, Mr. Chairman.

The Chairman. Thank you, Senator Lautenberg.

Senator Hawkins.

HIGHER INTEREST RATES LOWERED INFLATION

Senator Hawkins. I've listened to all the questions and answers here today and it seems to me that as the deficit forecasts widened late last year, interest rates fell. And now, as predictions on future deficits are falling, rates are going up. Is that correct?

Mr. Volcker. That's not my reading of the record. If you just look at the broad sweep of history with deficits going up and down, you will see an immediate correlation between larger deficits and lower interest rates. Why is that? It is because they are both related to the business cycle.

If you just look at average experience, you will see a big deficit in the middle of recession; interest rates are low and private credit demands are low in recession, so you will get a big deficit and low interest rates.

What you've got to do is abstract from the state of the economy in making the connection. Those analyses would suggest that once one adjusts for the cyclical state of business, the larger deficits are going to give you higher interest rates. In a colloquy with Senator D'Amato earlier, I indicated that the reality and prospect of what have been termed "structural deficits" is one factor which is holding up interest rates abnormally today, relative both to the state of business conditions and to the recent rate of inflation.

Senator Hawkins. Mr. Volcker, when you became Chairman in 1979, the prime rate was 12 percent. During your term, it was above this level 70 percent of the time. Do you feel this had much to do with the fact that the GNP has grown only 2 percent after adjustment for inflation over the past 4 years?

Mr. Volcker. As we discussed earlier, the economy obviously is going through a very difficult period. I think that that was, to some extent, a price we paid for the inflationary process and getting the inflationary process under control.

I think the economy would have had even more difficulty had that inflationary trend continued and accelerated.

Senator HAWKINS. But we have paid a price, in terms of slow growth and high unemployment, for slowing inflation.

Mr. VOLCKER. The job now is to avoid letting inflation rise again and paying the price over again. We've paid the price once. Let's consolidate these gains. I think that's the only basis upon which we can expect the economy to have sustained growth. By the time I finish here, I hope the prime rate is substantially lower, reflecting a more stable economy, a more satisfactory economic performance, and a longer period of disinflation.

Senator HAWKINS. Is it wise to urge slow growth now if we want to keep the national debt down?

Mr. VOLCKER. Wise to urge slow growth? I urge a sustainable growth, and that involves more than the the rate of speed in a quarter or two. We do need to keep the deficit down, yes, if what we want is sustainable growth; the speed in a quarter or two is not critical to that much larger goal.

Senator HAWKINS. I'd like to ask you some questions on the pricing of services supplied by the Fed to member banks. The GAO recommended a 1982 report that the Federal Reserve should move faster to achieve the Monetary Control Act's objective of pricing services to banks without subsidies. Previously, the justification for subsidies was that it compensated member banks for their failure to receive interest on reserves.

Now that you're recommending that interest be paid on reserves and this will be very costly for the American taxpayer, why not immediately eliminate the subsidy on the delivery of the services to the banks?

Mr. VOLCKER. We are now in a position where I can say that for priced services we have reached the overall objective of the Monetary Control Act. It's possible that we will have revenues in excess not only of cost but of the so-called private sector adjustment factor. At least we are running there at the moment, which allows for the equivalent of a profit that a private institution would make.

There are some very limited services that we are deliberately subsidizing within the framework of the Monetary Control Act. Those subsidies are being phased out. The principal example is automated clearinghouses where we are phasing it out on a schedule, but there was a decision to subsidize it for a period of time in the hopes that that service, which is basically in the interest of the banking system and the efficiency of the financial system, would grow rapidly. The intention now is to phase that subsidy out.

Some particular services are still running below the objective of the Monetary Control Act, but that's in the process of being changed now. There's been some pricing introduced just in the past few weeks that should bring balance in those services.

Overall, we expect this year we will have fully met those objectives.

Senator HAWKINS. Including the GAO statement that the Federal Reserve float was averaging about $4 billion daily at the time of the Monetary Control Act?

Mr. VOLCKER. It's much lower now. I think it's in the area of $1.8 billion; within a matter of months, what float remains will be priced. We are meeting that objective during the course of this year.

Senator HAWKINS. Thank you.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

PROGRAM OF TIGHT MONETARY TARGETS

Chairman Volcker, you testified earlier this morning in response to Senator Heinz that you didn't expect the two bouts of 20 percent interest rates that occurred in 1980 and 1981. Now, in retrospect, do you regard these 20 percent interest rates as justified? Justified in terms of fighting inflation?

Mr. VOLCKER. I suppose I do, considering everything that took place at those times. I'm not sure they were avoidable and I suppose, in that broad sense, they were justified.

Was it ideal that we had to have those kind of interest rates? Obviously not. I wish we didn't have to have them. I wish other policies had provided enough support so it wasn't necessary.

Senator SASSER. Well, following up on that, do you regard the recessions of 1980 and 1981 and 1982, together with the 10-percent-plus unemployment that we have experienced—is that justified in terms of combating inflation?

Mr. VOLCKER. As I said, I think we paid a heavy price for dealing with the inflationary process. Looked at over a period of years, all I can say is that if we let that process go on further, we would have had still more difficulty.

Senator SASSER. Do you know of any specific alternative policies in 1981 that could have averted the recession of 1981–82?

Mr. VOLCKER. When you ask, averted any difficulty, that's a tough question. I can certainly think of policies that would have made for a smoother adjustment; I'm not just talking about Federal Reserve policy, obviously.

Senator SASSER. I'm sure you're not, because I agree with you, Mr. Chairman, that the Federal Reserve should not take full responsibility for the recession of 1980 and certainly not for the recession of 1981–82; but I do think that the Federal Reserve policies largely contributed to it.

Now, if there were other policies that we could have followed which would have eased this problem of the recession we had in 1981 and 1982, why weren't these policies advocated to the Congress by the Federal Reserve at that time?

As I recall, sir, in your appearances before other committees in this Congress on which I serve, you provided consistent support for the economic program of the Reagan administration in the spring of 1981 which, acting together with the Federal Reserve Board, I think created the recession of 1981 and 1982. Certainly those economic policies are largely responsible for the structural deficit that we now have.

Was this a mistake in advocating these policies at that time?

Mr. VOLCKER. We would have to go back and look at the record, Senator. I would be glad to provide you with testimony I made during that period of time; I think you will find during that period

I recommended consistently quite a series of actions that were never taken.

Senator SASSER. I don't recall, just searching my memory this morning, Mr. Chairman. This is the first time I've heard you raise the issue that perhaps we might be well advised to raise revenues.

Mr. VOLCKER. Oh, no.

Senator SASSER. I recall well the testimony that we should cut spending, but this is the first time I recall you advocating raising revenues as a way of combating the structural deficit. But I am incorrect in that?

Mr. VOLCKER. Yes; you are incorrect in that.

Senator SASSER. Chairman Volcker, you have never fully endorsed the set of economic doctrines and all this monetarism that's become voguish in recent years in Great Britain and to some extent in this country. Nevertheless, under your chairmanship, the Federal Reserve has from 1979 through the middle of 1982 followed a rigorous program of tight monetary targets.

Now to the relief of many, including myself, in the summer of 1982, the Federal Reserve decided to relax its monetary targets and since then money growth, by all measures, has been rapid.

In setting money targets for 1983, the Federal Reserve has again showed flexibility and you stated that in February 1983 you would pay less attention to M_1 than you had previously. But now there are rumors that you might return to tightening monetary policy in response to fluctuating money growth, and who knows what this will mean for the economy?

Would you give this committee an unqualified assurance that you will base monetary policy decisions on the performance of the economy rather than on the mechanical monetary supply targets?

Mr. VOLCKER. I don't know quite what you mean by that dichotomy. The growth in money is one part of the total economic performance.

Let me, if I may, correct the record as you read it. I do not read monetary expansion in all its dimensions as you indicated since last summer as being more rapid than before. That is true of M_1. I do not believe it's true of M_2 and M_3 unless you include a period for M_2 when the money market deposit account was being introduced; there was an explosion in money market deposit accounts which affected and distorted greatly the M_2 figure during that period of time. Otherwise, both M_2 and M_3, bank credit, total credit, have been following a growth pattern very much similar to the pattern they had been following earlier; and, indeed, today they are roughly consistent with the targets that we established at the beginning of the year.

I don't want to suggest that policies since the middle of last year have ignored all measures of monetary growth or all those measures of monetary growth are somehow skyrocketing. They are not. I have indicated repeatedly that in looking at these monetary numbers we have to use a degree of judgment, particularly in a period when the institutional setting is changing rapidly and when the economic setting is changing rapidly, so that past relationships between those aggregates and the economy may be changing; that requires judgment. In making that judgment, we have to look at what's going on in the economy generally and we have to look at what price trends are. We have to look at leading indicators of either price trends or the economy. We look at the exchange market. We look at all those factors that I take it from your question you think are relevant; I agree they are relevant, and we look at them.

SLOW ECONOMIC RECOVERY CAUSED BY HIGH DEFICIT RATE

Senator SASSER. Mr. Chairman, my fear and I think the fear of perhaps others in the country—and judging from what I read in the press, perhaps even a fear of some in the White House—is that we may set these arbitrary monetary targets and as we start exceeding those targets in the growth of M_1 we start pulling back; and interest rates, as a result, go up and we snuff out this recovery of the economy.

A distinguished economist the other day stated that this recovery is like a three-stage rocket: that the first stage is that of inventory replacement and we are well into that; and the second stage is return of consumer confidence and consumer spending, and certainly we are well into that; but the third and most critical stage that really puts us into orbit is when business starts expanding its investments, and we are seeing predicted for 1983 lower business investment than we saw in 1982 for capital expansion which was lower than we saw in 1981.

So that's really my concern, Mr. Chairman, that we are going to move back to arbitrary money growth targets and that's going to snuff out this recovery before that third stage can really reignite and move us into a period of substantial, continued and sustained recovery.

So that's why I seek assurances from you that you will base your judgments more on the performance of the economy than on what I consider and others consider to be arbitrary monetary targets.

Mr. VOLCKER. Let me say, first of all, that there are some indications already, rather sooner than most people expected, that business investment may be expanding, particularly in the equipment area, although there are certainly weak spots; certainly commercial construction remains a weak spot in the economy and I suspect will for some time.

But to deal with your broader question, obviously we do not think that the monetary targets are arbitrary and capricious. We recognize considerable uncertainty in evaluating those targets. A certain amount of flexibility is necessary, and I agree that we have to look at various indicators of economic performance in arriving at a final judgment on monetary policy.

That does not mean that it is no longer useful to look at the rate of monetary growth and reach judgments on that matter in the light of all the surrounding circumstances.

I would add only one other comment, which is I suppose repetitious of what I said earlier in terms of your three-staged rocket. I think that there is some truth in the normal analysis of a cyclical recovery, and it is precisely in that context that I think we have to look beyond what's happening, let's say, this quarter in the economy or in financial markets in reaching our policy judgment as to what's going to produce the best environment 6 months from now, 9 months from now, 1 year from now. If things get out of control in a monetary or inflationary potential sense now, it's not going to help 1984.

Senator SASSER. My time has expired. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

Chairman Volcker, you have been very patient this morning. Let me focus on a line of questioning that was being developed by Senator Riegle because I, for one, will support your renomination primarily because I think you have been consistent during your term. Repeatedly, in your appearances before the House and the Senate you have maintained a view that your job was to set monetary policy based on fiscal policy, that it was the executive branch's job and the Congress job to set that fiscal policy, and our monetary policy would be reflective of that fiscal policy.

I realize it's been a historical tradition of the Fed to not become involved in the specific legislative proposals, but consistently over the last 2½ years at any rate, you have maintained and you have again this morning maintained that the No. 1 problem we face is deficits; that, in fact, the high deficit rate is what is causing a slowdown in the economic recovery.

In the February 18, 1981 program for economic recovery, the President predicted and forecasted the following level of deficits: in 1982, he said we would have a deficit of $45 billion; in 1983, $22.9 billion; and in 1984 we would show a half billion dollar in surplus; in 1985, a $6.9 billion surplus; and by 1986, almost a $30 billion surplus in our deficit picture.

Now, obviously, you and I didn't know what David Stockman knew when he gave his interview to the Atlantic Monthly; that those figures were basically wrong and nobody knew what they were talking about at the time.

I wonder if you might tell us, based on the Fed analysis, what the deficit picture will look like over the next 3 years?

Mr. VOLCKER. Somebody sitting down and making those estimates obviously has to make some judgments about what Congress is going to do or the character of the budget resolutions, and you get involved in some noneconomic judgments when you make that kind of an estimate. But I think our analysis, allowing not only for the uncertainties in any forecast but the uncertainties in the political judgment about how much in fact is going to be done by the Congress, does suggest that those deficits will remain in the $200 billion area for the next couple of years.

FED SHOULD NOT GET INTO BUDGET DECISIONS

Senator DODD. Now, if that's the case, and we know roughly—and obviously there have been some minor adjustments, but the President's proposed increase in defense spending was roughly $250 billion over 5 years and the tax cut would be roughly $750 billion over 5 years—$1 trillion.

Now you're repeatedly rather outspoken in your testimony about budget cuts. You talked this morning again about the structural deficits, that normal economic growth would pick up some of those deficits and a sluggish economy obviously would cause some of it.

My concern has been why you haven't been more outspoken, if in fact the deficits are the major problem, when we were talking about the massive increases in defense spending and the Kemp-Roth tax cut—why you did not tell the Congress in more outspoken terms that those were going to contribute to the failure of sustained recovery.

Mr. VOLCKER. I think you can find a lot of evidence in the record that I spoke about the deficit. You may not find in the record quite the same explicitness about any particular measure to take, just as today I'm a bit reluctant to comment on a particular measure.

I'm interested in the bottom line and I don't consider it the province of the Federal Reserve to suggest to the Congress whether defense spending is good or bad or whether a particular tax program is good or bad outside of some general limits.

Senator DODD. Mr. Chairman, it contributes to the No. 1 problem that you have identified. Let's say in retrospect, Kemp-Roth is a fait accompli. It's law now. It's been adopted and signed. Do you think Kemp-Roth is wrong?

Mr. VOLCKER. I expressed reservations at the time about the size of that tax cut and, as you remember, going through the congressional process, it suddenly got bigger than the administration had initially proposed.

Senator DODD. So it would be your conclusion today and you're telling this committee that in fact this was a mistake?

Mr. VOLCKER. Given everything else that has happened. But the problem I have is, you could have, theoretically, had that tax cut and, if expenditures had been cut by another $50 or $100 billion, you would be all right.

Senator DODD. Then it's in combination with the $250 billion increase in defense spending.

Mr. VOLCKER. It's no particular measure that does it, because one measure can always be offset by something else; it's the net total, and I don't really think I should be in the position of saying which particular measure deserves the priority.

Senator DODD. This wasn't just a small measure.

Mr. VOLCKER. No, and we had a lot of discussion about it, and I think I did express some reservations—maybe not as clearly or as forcefully as you might have liked or in some sense I might have liked, in retrospect. The problem still remains now and in the future. I don't think it's basically my job to suggest to you what the national priorities that are inherent in the budgetary process should be.

Senator DODD. I know that's been the tradition of the chairmen of the Federal Reserve Board and I appreciate that, but I think you and I have come to appreciate the fact that when Paul Volcker speaks, people listen, that you and the Federal Reserve enjoy a status that goes beyond what people normally assume motivates or drives the President of the United States or the Congress, either as a whole or individually; and that when we are talking about the No. 1 problem in terms of a sustained economic recovery, then the Chairman of the Federal Reserve is rather quiet about two major provisions that are going to create this very problem I'm perplexed why you can't speak out on those matters.

Mr. VOLCKER. It's drawing a line—and it's a very delicate line—between speaking and intruding, if it had any influence anyway, on what I think are political decisions—in the wider sense of the word political—that you people in Congress are called upon to make. I can tell you what I think is necessary and desirable at the bottom line, from the standpoint of economic policy, but I can't tell you what good defense policy is or what good social policy is.

Senator DODD. I wasn't expecting you to come out and take a position on particular defense items. We are talking about the total.

Mr. VOLCKER. Even the total defense budget. It's not my business. I know it contributes to the deficit. From the economic standpoint of the deficit, reducing the defense budget is a good thing. Whether it's a good thing for the country, balancing all the priorities, is a judgment you have to make.

Senator DODD. I want to jump to the subject of the IMF now. We still have pending before the Congress—the Senate has passed it but the House has not—the loans to the IMF.

Is it your opinion that that will be satisfactory to satisfy and meet the commitments of the Third World countries?

Mr. VOLCKER. The quota increase and the increase in the GAB, I think, will be adequate for any foreseeable time period, for several years. But you have given me the opportunity to say that the absence of that increase would be a devastating blow to the capacity of the IMF to do its job over the next few years.

I think that legislation is an absolutely crucial element in managing the international financial strains which are evident. Some progress has been made and the situation has been managed thus far, but the potential needs remain very large, and that legislation is needed, both in terms of the quantities involved and the psychological message that would send.

Senator DODD. Well, I agree with you on that. I think you're correct.

My concern is, as you know, many Members of Congress are being questioned by their constituencies as to whether or not even this amount is appropriate. My concern is whether or not this amount, assuming Congress will adopt it, is going to be adequate or are we going to find ourselves back here again within a year or so?

Mr. VOLCKER. Not within a year or so.

Senator DODD. You don't see that?

Mr. VOLCKER. No.

Senator DODD. Thank you. Mr. Chairman, I will stop there. Thank you.

The CHAIRMAN. Senator Sarbanes.

CHAIRMAN'S 4-YEAR TERM SHOULD START AFTER ELECTION

Senator SARBANES. Thank you, Mr. Chairman.

Chairman Volcker, I want to pursue further a subject on which Senator Proxmire touched. I take it that it is your position, and the position of the Board of Governors of the Federal Reserve, that the term of the Chairman should be a 4-year term, to begin at the end of the year in which a President takes office.

There have been various proposals over the years that it should begin anywhere from 6 months to a year after a President comes into office. That would, to some extent, take it out of the immediate political context would still enable the President to have a Chairman of the Federal Reserve with whom he felt comfortable and vice versa, and I take it you would support legislation of that sort.

Mr. VOLCKER. Yes. To be precise, I think the natural time to do it—and it happens to be convenient technically—would be January 31, when the term of a member of the Board of Governors would expire anyway, so there would be an automatic opening on the Board if there was a desire for a new appointment.

Senator SARBANES. The current system, has no rationale to it. The Chairman gets 4 years from whenever he's named, which means it could fall at any point in the Presidential cycle. There is no definitiveness to it and therefore it's a matter of constant speculation one way or another. We have the situation now where your reappointment is coming up more than 2½ years into the 4-year term of a President.

Would you agree that there is no rationale to it, really?

Mr. VOLCKER. It's got no particular rationale except maybe the virtue of being accidental, which takes it out of any connection with the political process, narrowly construed. I think the major danger of the present system, as I see it, is that suppose by accident an appointment came up in the midst of an election process or in its immediate aftermath; that would be bad, and the only thing that prevents it now is the accident of history.

We did have a long period—accidentally, but it happened de facto to be the case—when the appointment was a year after the President took office. It just happened to be the way it fell for a good many years. Then it got thrown off that cycle when Chairman Miller resigned before his term was up.

Senator SARBANES. And you think that cycle was, all things considered, probably a more desirable way to approach it?

Mr. VOLCKER. All things considered, it's probably more desirable. It's got one difficulty which the Board has noted from time to time; that if you have it on a fixed cycle instead of 4 years from whenever the appointee takes office, you do run into the chance in case of a resignation or death, that you would have a very short term.

Senator SARBANES. You have made the recommendation that that be tacked on and you have a term that could run as long as 5 years.

Mr. VOLCKER. Exactly.

Senator SARBANES. Now I take it, in reading your disclosure statement to the committee, that in fact, even if the law were not to be changed, we might be put back on that cycle that existed before because you have made it very clear, at least as I read it, that you don't intend to serve out fully this term. That is my understanding.

Mr. VOLCKER. That may state it a little too strongly. What I don't want to do is suggest to the committee that I feel obligated to stay the full term. I don't want to suggest there's any commitment one way or the other, except that I did suggest I didn't necessarily want to be committed to staying the full term.

Senator SARBANES. The question then, Mr. Chairman, is this: at the time of your first nomination, you were asked, "Do you expect to serve the full term for which you have been appointed?" Your answer was "Yes." This time the question is, "Do you expect to serve the full term for which you have been appointed?" and the answer is, "I do not feel committed to do so."

Mr. VOLCKER. Correct.

Senator SARBANES. Now I take it that that difference in response has some significance.

Mr. VOLCKER. It has some significance. I remember very well the question. I didn't remember answering the question in writing, before, but I remember it arising in the oral testimony, and if I make a commitment to the committee that I'm going to stay the full term, I mean to honor that commitment. I didn't want to be quite so firm about it this time.

Senator SARBANES. I read these answers in conjunction with your previous statement that you regard it as desirable for the Chairman of the Federal Reserve to serve 4-year term beginning roughly a year or so after a new President is installed. The date you used was January 31.

Mr. VOLCKER. I'll put those two positions together in this way, if I may. When I say I wouldn't want you to think I feel committed to serve the full term, I recognize very clearly the undesirability of not serving through the election.

Senator SARBANES. That's another point you made. I was just going to go into that.

Mr. VOLCKER. I recognize very clearly the undesirability of leaving in a short period of time after the election.

Senator SARBANES. And you also recognize the desirability, as a general proposition, that a newly elected President, within a year, say,of the time he takes office, should be able to name a Chairman of the Federal Reserve?

Mr. VOLCKER. I at least recognize that if I did leave sometime in that time period or thereafter, it's not inconsistent with my view as to what is appropriate over a period of time.

Senator SARBANES. As I understand it, as a general proposition, you don't think the Federal Reserve Chairman should be picked in an election period?

Mr. VOLCKER. That is correct.

Senator SARBANES. And you don't think he should be picked immediately after a new President comes in because the President needs to settle into the job?

Mr. VOLCKER. That is correct.

Senator SARBANES. But you do think that a newly elected President, roughly a year after he comes in, ought to be able to name a Chairman of the Federal Reserve to a 4-year term, roughly coordinated with his term?

Mr. VOLCKER. On balance, I think that that's desirable and have said so before. I would not have taken that attitude 4 years ago because it would have given me a very short term by the accident of history, and I think I have been around long enough so that particular consideration is irrelevant.

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FED POLICIES HAVE HAD ADMINISTRATION SUPPORT

Senator SARBANES. I take it that throughout your tenure as you have dealt with this administration, you have felt that the administration supports them and approves of the policies you're pursuing at the Federal Reserve. Is that correct?

Mr. VOLCKER. I can let them speak for themselves.

Senator SARBANES. No, I didn't ask what they thought. I asked what you felt about what they thought. In other words, your view was that you were following policies which the administration supported; is that correct?

Mr. VOLCKER. There have obviously been particular times, if I read the press correctly and assume the reporting was accurate—and sometimes there were direct quotations—when they weren't particularly happy. I think there were quite a few occasions of that sort, liberally reported.

But having said that—I think we have had some colloquy about this before—in terms of the broad thrust of policy, I think they must have been reasonably satisfied.

Senator SARBANES. Mr. Chairman, you're a good witness because we have had this colloquy before.

Mr. VOLCKER. And you got a consistent answer.

Senator SARBANES. In July 1982, I asked you, "Would you say the policy the Federal Reserve is pursuing in the monetary area is a policy which the administration wishes it to pursue, that the Federal Reserve and the administration are consonant on monetary policy?" And you responded, "I am, as I said before, not aware of any real problems in that respect. I think they have generally been supportive of what we are trying to do and the general way we go about it, but I guess you would better address the question to them." And I said, "No, I'm interested in knowing your perspective of their view of your role. I take it from your answer that your perspective is that they in fact support the policy which you are pursuing; is that correct?" And you responded, "In general terms, that's certainly my impression, yes."

And I take it you would continue to respond that way?

Mr. VOLCKER. In terms of the broad thrust. I suppose my renomination would be broadly consistent with that view at least.

Senator SARBANES. Well, I would say so. And I was just going to say, wouldn't you be reasonable in assuming that the policies you were pursuing are satisfactory or agreeable to the administration, first on the basis of your reappointment and, second, because the President, when he did so, said, "I have today asked Chairman Paul Volcker to accept reappointment for another term and he's agreed to do so," and—this is the President speaking—"and I couldn't be more pleased."

So I take it you feel that you have followed policies consistent with and supportive of the approach which the administration wishes you to take?

Mr. VOLCKER. I find your wording a little bit prejudicial. I have to let the record speak for itself. I think the President also indicated, quite correctly from my standpoint, that we have a certain independence, and I presume he doesn't want to associate himself with every policy decision we make. If you interpret as a policy decision a decision to change the discount rate, to change the monetary target, to provide funds or withdraw funds through open-market operations, I don't think they want to be associated with all those decisions. I think they have clearly disassociated themselves from some of those decisions.

But if I can make a distinction between policy at that level and policy in its broadest sense—a concern about inflation, a concern about maintaining control over the money supply and liquidity—then, yes, I think that has been in accordance, as I understand it, with their feelings of an appropriate monetary policy.

Senator SARBANES. Well, you don't have discussions at the Federal Reserve, do you, that you're pursuing a policy counter to or contrary to what the administration wishes you to follow? Have you done that?

Mr. VOLCKER. We don't have discussions at the Federal Reserve——

Senator SARBANES. Do you feel that you have followed policies contrary to what the administration wishes you to pursue?

Mr. VOLCKER. Again, I'd have to make the distinction I just made. I think we are conscious at times that a particular decision we make may not be quite——

Senator SARBANES. If you haven't followed such policies, why were you reappointed?

Mr. VOLCKER. I presume in the broadest sense there is a consistency, just looking at monetary policy itself. I take it there is a broad sense of sympathy as to the basic objectives, the basic approach. I just don't think I can pin down that that means agreement on every particular policy decision. We have had many differences with the administration on particulars of monetary policy and on other matters. We do not always take the same positions on legislative matters, for instance.

Senator SARBANES. Do you feel you have gone against the administration with respect to monetary policy, or that you have generally followed a course satisfactory to them, which they support?

Mr. VOLCKER. All I can say is that we are following a course on monetary policy, in its most basic sense, that seeks to have sustainable economic growth and, inherent in that process, in my judgment, is maintaining control over inflation. At this level, I think there is agreement.

Senator SARBANES. And you feel that the administration has been supportive of what you have been doing?

Mr. VOLCKER. I think they are supportive of that concept, as I understand it, yes.

Senator SARBANES. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Proxmire.

SUSTAINED REDUCTION IN UNEMPLOYMENT IS FED'S GOAL

Senator PROXMIRE. Mr. Chairman, I just want to follow quickly—I realize the hour is late and I will be as brief as I can on this, but I'm still somewhat shaken with this notion which didn't occur to me before, that you might not serve the 4-year term and therefore you will have a narrower perspective, as every President has as he nears his reelection. That's why I asked you whether you would give this committee an unqualified pledge that your policies as Chairman will be governed solely by the needs of the economy regardless of how these policies may affect the fortunes of either political party, especially in next year's presidential election. You simply said yes.

That was one question you answered this morning that I think was confined to a single three-letter word. I want to know how unequivocably, how absolutely, how final, how firm, how sure, how total, how positive that three-letter answer is. Could you massage that little yes, in with a few adjectives?

Mr. VOLCKER. I would have thought any massaging would have suggested some qualification, which I didn't want to convey. It seems to me all I can do is repeat yes without any qualification.

Senator PROXMIRE. So you wouldn't differ with my interpretation that your answer was unequivocably absolute, final, firm, sure, total, and positive?

Mr. VOLCKER. Yes. I should say no, I would not differ.

Senator PROXMIRE. It is absolute, it is final, it is firm, it is sure, it is total, it is positive?

Mr. VOLCKER. Yes.

Senator PROXMIRE. Good.

Now, in all fairness, I think in part the answer to Senator Dodd's questioning which I thought was very useful to us—and I know some people have criticized you for not being sufficiently specific due to the timing—you wrote me a letter in response to a request from me in 1981. Here are two sentences from that letter. "It is critical that tax cuts be conditioned on the maintenance of budgetary discipline—[quoting]—our national security and other needs clearly place limits on the amount of tax reduction that would be prudent at this time—[quoting]—at more satisfactory levels of economic activity could be counterproductive."

I think that's about as explicit as we could expect to get.

Now let me ask you a followup question on the question that Senator Byrd wanted to be sure you were asked. Don't we need economic growth of at least 5 percent to make a significant dent in unemployment so that the hardest hit States and communities share in the recovery?

Mr. VOLCKER. You've got to put some time dimension on that. You will make a significant dent on unemployment with lesser growth than that—depending on what you mean by significant—but 5 percent is not an exceptional growth rate for the early stages of recovery. I would think we would probably do better than that this year.

Senator PROXMIRE. Well, in a conflict between staying within your target range for the monetary aggregates and reducing unemployment, which way would you decide?

Mr. VOLCKER. I can't answer that question, given that amount of information. Ultimately, obviously you want to reduce the rate of unemployment. The question is how you get there and how you get there most sustainably, and you probably put that question in a very short-term context when I would prefer to look at it in a longer term context.

In a longer term context, if you reached the judgment that sustainable reduction in unemployment required not keeping within some monetary guideline, then that would suggest the monetary guideline is wrong and you ought to change it. I put the question in the context of sustained reduction in unemployment, and the monetary guidelines are designed to reach that.

I come back to this point because I think it's fundamental to my thinking and you ought to be aware of it: I don't think you're going to get that sustained reduction in unemployment except by paying attention to inflationary problems at the same time. I think you've got to go together on these things. Otherwise we will be thrust back in the same position that we were in earlier in the late 1970's, when you had an inflationary situation damaging to business development. I have no trouble in answering that question, and the objective, in a larger sense, over a period of time, is to get unemployment down. You've got to combine that with financial stability.

M_1 GROWTH, GROWTH PROJECTIONS, AND CAPITAL RATIO

Senator PROXMIRE. Now we are all concerned—you are and all of us are—about rising interest rates. The markets have a fixation with M_1 and at times so does the White House which now wants the M_1 slowed without rising rates. At the same time, the administration is complacent about the enormous deficits. We have a slack economy, 10 percent unemployment, and less than 70 percent industrial capacity.

No one knows what M_1 growth really means any more because the Super NOW accounts and the regular NOW accounts under the old definition of M_1, the growth over the past 6 months has been only 5 percent. As a matter of fact, currencies are up $8 billion, demand is up $4 billion, seasonally adjusted. Why should anybody pay attention to M_1 growth if we can't interpret it accurately, and yet the Fed has been unable to reflect attention away from it? Why not put M_1 aside and concentrate on monetary base?

Mr. VOLCKER. We have deemphasized M_1, but——

Senator PROXMIRE. You have tried, but it always comes up.

Mr. VOLCKER. I don't think that's quite fair. It always comes up in some sense. You say we don't know what M_1 means. I wouldn't want to define precisely our judgment on M_1 for some of the reasons you suggest; but when the changes get large enough, that raises a question. While we don't give M_1 the same weight that we gave it earlier, that might change if we had more confidence over a period of time. That doesn't mean there isn't some area between giving M_1 full weight and ignoring it entirely, especially when the changes are very large. We have not been in a position of ignoring M_1 entirely. It is one factor based upon some analysis of what's going on in the economy, with all these other factors that Senator Sasser and others are worried about. We look at all those and evaluate M_1 in that context, but we just don't put blinders on and refuse to look at the figure.

Senator PROXMIRE. Now I have been told that last October the so-called green book prepared for FOMC, the Open Market Committee members, contains an estimate that real growth in 1983 would average zero percent compared to 1982 and inflation would average 2 percent. These projections were substantially under the amount of growth in inflation being predicted by other forecasters.

My question is, No. 1, Were these projections in fact provided for the Open Market Committee?

Mr. VOLCKER. I don't remember any projections of that sort.

Senator PROXMIRE. You don't remember those?

Mr. VOLCKER. No. I don't think we ever had a projection like that. The figure we presented to the committee earlier in February indicated growth in 1983, and that now appears highly probable.

Senator PROXMIRE. This so-called green book is prepared for the Open Market Committee. It's not squared with the consensus of projections by outside economists. Does it bother you that the Fed may be basing policy on staff projections not subject to rigorous criticism by outside economists?

Mr. VOLCKER. No: that is one factor in policy consideration. The Federal Reserve banks go through similar exercises. They reach their own view. We, of course, have access to outside projections. I wouldn't overestimate the weight put upon that particular set of projections. They are fallible like other projections, and at least I'm well aware of that fallibility. We do have an expert staff and what I want to get from them, just speaking as one Governor, is their best, unbiased, private, if you will, assessment of what they think is going on; that's important to me, but it's just one factor in the equation.

Senator PROXMIRE. I apologize to the chairman of the committee. I do have one more question and the chairman has graciously permitted me to ask it.

Recently the Federal Reserve announced that the Nation's largest banks must maintain at least 5 percent capital ratio. I'm delighted to see that. I think that's an extremely important decision. As we all know, they have been below that and they have been in jeopardy because their capital ratio has been, in my judgment, too low.

How will that regulation be enforced and what happens to the large bank that falls below 5 percent? Do you just talk to them or are there real teeth in the regulation?

Mr. VOLCKER. I don't think we envisage that regulation as something you have to meet on a weekly or quarterly basis, although it is a very firm policy. I might add, in stating the policy, we raised the question that sometime in the future we may want to raise that ratio. It's not the kind of thing a bank cannot fall below, but if it does it will be talked to, in the first instance, and if the bank remained below, it would be asked for plans with respect to capital ratios and other things that would affect our attitude toward applications for expansion where there is a drain on their capital position.

Through that kind of process, through the normal examination process, there would be, I think, ample opportunity to bring pressure to bear progressively to conform to the policy. But it does not mean for periods of time a particular bank could not fall below. Some banks just now introducing that policy in that particular form are below and we would expect some of them would take some time—not too long, I hope—to get up to this minimum, but we don't have a fixed or rigid time schedule in that respect.

Senator PROXMIRE. That's very reassuring. I very much appreciate it.

The CHAIRMAN. Senator Riegle.

POLICY ADJUSTMENTS MAY BE NEEDED

Senator RIEGLE. Mr. Chairman, I'm going to try to go through this as quickly as I can, and I would appreciate you being as explicit as you can as we do it.

I want to pick up where we left off before in trying to make sense of the overall policy mix—fiscal policy, monetary policy, trade policy, other factors that fit together to create what is really I think quite a revolutionary and new economic environment as we're trying to chart our way forward.

Here's my concern. If we take a major piece of policy and look at where they are and the course we are now on, the fiscal policy you now say the Fed is anticipating deficits out over the next 2 years, but I think you could as well have said 3 years, in the $200 billion range. The merchandise trade deficit is estimated at about $70 billion and it's rising. It's up from about $36 billion last year, so you're almost getting an exponential rate of change, and that tends to be a byproduct of these other policies. I don't see any appreciable change in the savings rate in this country in terms of any fundamental change in pattern that's going to create a new pool of saving to feed into the system beyond what we have seen before.

When I add all these things together, I say to myself, I don't think this policy mix, if left as it is, is going to work indefinitely without creating an inescapable upward pressure on interest rates which in all likelihood is going to snuff out the recovery. It's more a question of when that would happen, and I think the financial markets themselves have sort of reached that judgment.

I think that's one of the reasons that long-term rates are hanging as high as they are and there's so much nervousness and you're talking to the same people I am, not only in terms of the decisions that are reflected in where those rates stand, but what they say to you in private conversations.

The reason I want to pin this down is this. If we need to make some major adjustments in different core areas of economic policy in order to get the overall policy mix that we need and that's a constraint that monetary policy has to bump up against and everything else, then I think today, right here, we've got to make that as explicit as possible and we've got to get it out in the open and make sure everybody understands it.

And I gather that you're saying delicately that the mix we now have is not guaranteed to work, that it's going to have to be adjusted and that the fiscal policy part is one significant part that you have touched on and I don't know how far you might be prepared to go with any of the others, but we have also touched on the international lending relationships in financing, steps that have to be taken here, because it seems to me that's a critical part in another way if we were not to get the IMF quota increases that I think impinges on this in a very risky way.

What I'd like you to do here is try to be as explicit as you can be in saying what the other policy areas of adjustment are needed here, and are they needed to make this thing work, and if it's your private and professional view that this whole thing may self-destruct at some point if we don't make these adjustments, no matter how it's done—I'm not asking you to get into the details. I'm asking you to make the larger assessment here. If we are running a high risk that this thing will self-destruct unless those adjustments are made, then I think it's very important that this be said and understood. I think there are a lot of people around here that would be inclined to agree and perhaps that would move us ahead to some of these adjustments that are going to have to be made. Otherwise, I'm afraid this may all land on the notion that monetary policy being the final step that has to resolve beyond too many things it can't do.

Mr. VOLCKER. Let me make a couple points that will make it very easy for you, I'm sure. You covered the budget, and I think the risks in that situation are apparent, even with a relatively optimistic view. I wouldn't underestimate the importance of the progress we have made against inflation in helping to keep interest rates lower, even with the budget situation looming there, but certainly the budget makes them higher than they otherwise would be.

You spoke about other areas. I referred earlier to the importance of maintaining moderation in pricing and wages. You have referred, and perhaps I touched upon, the international economic and financial problems. I think a major contribution that the United States can make and must make to that larger world situation, while at the same time contributing to moderation at home, is to avoid protectionism. You can put it either in the negative or the positive. Let's not take any more restrictionist measures, and let's think, with the economy moving ahead, of removing those that were put in under the pressure of recession. I think that would send a very clear and helpful signal to the community at large about domestic competition in pricing and at the same time make a very real and really essential contribution, as came out very clearly at the Williamsburg conference, to the world situation and the problems of the developing countries, our neighbors to the south and elsewhere.

Senator RIEGLE. Well, I hear what you're saying. I don't want to get off on the protectionism thing because the whole world is honeycombed with protectionism, some even financed by central banks and other trading competitors. So that's a major problem.

Let me ask you this question. If the deficits do stay above $200 billion, aren't we almost certain to see interest rates forced back up and this recovery at some point start to go the other way? I mean, can we really live with that? I'm talking about with a realistic expectation that we are going to get sustained economic growth, we're going to have a low inflation environment, we're going to see unemployment coming down.

Mr. VOLCKER. You're quite right that that is a major worry. I'm reluctant to say that it is inevitable because we have one countervailing force, and that is the progress we have made against inflation. If we lose that and combine that with those budget deficits, then, yes, I would say it's inevitable. The budget deficits put a lot of pressure on, and they will keep real interest rates high, whatever the inflation rates do.

Senator RIEGLE. I've seen that.

Mr. VOLCKER. We're starting out with a high level of nominal interest rates and a high level—in the loose sense of the word—of real interest rates. I know that deficit will keep real interest rates higher than they should be, but I still have this vision that if we can combine recovery with continued progress against inflation we've got a source of downward pressure on interest rates that will be very helpful. There's no question it's directly countered by the deficit situation. Where the net balance is, I don't know.

Senator RIEGLE. Some people are saying today that everything that needs to be done has been done, that we are now on the right course and we don't need any other major economic policy adjustments. It's just a question of sort of going on down the road.

I can't bring myself to share that view. I see too many things that tell me we've got too many contradictions here that we've got to resolve. I think I hear you say that too. You're obviously careful not to say it in too pointed a way.

My point is, if you think there are major things out of line here that threaten this whole situation working out properly, then I think the time to say that is now because if we don't make the changes we are going to end up with the worst consequence, and that may be no way out of this thing.

Mr. VOLCKER. I don't think I'm disagreeing with you. You seem to think I'm not saying it loud enough. I'm saying it as loud as I can, but in the context of wanting to be accurate. What I'm saying is bad enough and I'm not going to be more alarmist than I think the situation deserves. It seems to me I've said things that are not very happy, to say the least.

Senator RIEGLE. Let me just try one last time. Would you generally agree with the proposition that our overall economic policy mix still needs some major adjustments here?

Mr. VOLCKER. Yes; and I think the deficit is the No. 1 problem, and I urge that action be taken to deal with that if you want to devise any kind of assurance of an orderly, sustained recovery.

Senator RIEGLE. And if it doesn't happen, we run a very high risk?

Mr. VOLCKER. Yes; without any question.

Senator RIEGLE. I want to ask you one other thing.

Mr. VOLCKER. They are not necessary risks.

JAPANESE MAINTAIN AN UNDERVALUED YEN

Senator RIEGLE. I want to ask you one other thing about the general situation because I wonder if you believe that the dollar is overvalued in relation to the Japanese yen and how do you explain the fact that while U.S. interest rates have declined dramatically the Japanese yen has appreciated very little? We seem to be caught in a situation here where that differential consistently works to our disadvantage.

Do you think in any way that somehow this is being artificially maneuvered or do you have a concern about it?

Mr. VOLCKER. I don't think it's being maneuvered in the sense of a conscious monetary manipulation by the Japanese Government or the Japanese Central Bank to maintain an undervalued yen. Indeed, I think, on balance, the responsible authorities there are concerned about the yen being too low relative to other currencies generally, and that has some disadvantageous byproducts for them, ranging from putting more pressure on internal prices than is necessary and increasing pressure abroad, and all the rest. I don't think they are artificially manipulating them in that sense. There are problems with the Japanese trade policy; structural problems.

Senator RIEGLE. I'm familiar with those.

Mr. VOLCKER. But I don't think the yen is being artificially manipulated.

Senator RIEGLE. It seems awfully strange to me that we never seem to see this swing in our favor. It seems always to be in an adverse situation.

Mr. VOLCKER. I don't think that situation is entirely comprehensible to many economic analysts who have looked at it, either in Japan or here. You can understand some elements of it, but they have a growing current account surplus and we, of course, have a growing current account deficit. The interest rates are much more closer in line, as you note, than they were a year ago, although our interest rates are still higher than theirs, and they would put a lot of weight on that factor. For a while I think an important factor was the fact that they had liberalized the outward flow of capital. I don't think they did that to manipulate the yen, but it had the effect of depreciating the yen, because for the first time many investment institutions in Japan engaged in a large diversification abroad; they spent yen and bought dollars in the process, but that happened 2 or 3 years ago. I would think the initial so-called stock effect would be pretty well washed out by this time. Of course, the exchange rate has been around the current level for quite a period of time and it doesn't get jarred in a different direction, but I can't fully explain it to my own satisfaction and therefore to yours.

Senator RIEGLE. My time is up. I think you need to do some more work on it because we are in deep trouble there and the trends are in the wrong direction.

The CHAIRMAN. I'd like to inform the Senator from Michigan that I do not own nor intend to own a Japanese car.

Senator RIEGLE. Thank you. Now if you will just go to the Chrysler legislation next time, we're all set.

The CHAIRMAN. I hope Chrysler never needs any more legislation.

Senator Dodd.

SAVINGS, INTEREST RATES, AND NEW BOARD MEMBERS

Senator DODD. Just very quickly, I'd like to pick up on Senator Riegle's last line of questioning with one add-on.

As I understand it, the deficit, while we have all recognized its importance, really becomes important as it relates to the rate of savings. Do you agree with that?

Mr. VOLCKER. Yes.

Senator DODD. There have been some estimates as to what the savings rate growth figures would be like. What would be your estimate under the coming years as to what we might expect in a very optimistic way as to the rate of increase in savings?

Mr. VOLCKER. I would hope that it would go up, but I think, given our economy, it's wrong to count upon a really dramatic change. I think we have taken some measures in tax policy and elsewhere that favor savings relatively, at least in the sense of removing what were relatively impediments for savings before. I would hope that would have some effect over a period of time.

Maybe even more important would be a feeling of greater stability in terms of inflation. But if one looks way back, in postwar history anyway, the American savings rate by international standards has been low, and I would not expect that the American savings rate is going to jump to the German savings rate. If it increased by 1 percent, that's a pretty big percentage increase. That's helpful, but it still doesn't cure a 3-percent budget deficit.

Senator DODD. In light of that, it seems to me that regardless of what monetary policy is, we are going to be faced with an interest rate hike. If you tighten monetary policy, you get an interest rate hike. If you loosen monetary policy, you get a likely new round of inflation which would also require the raising of interest rates. While you didn't use the word inevitable and while certainly the Fed is going to play a part in all this, I'd like to know whether or not you think I'm off base by suggesting that you're out of the game, that regardless of what you do in monetary policy we're going to have a rise in interest rates.

Mr. VOLCKER. It depends upon what time period you're talking about. My basic point of departure would be that if we can maintain and continue the progress against inflation over time, interest rates are going to come down. Now that prospect can be disrupted for a period of time, to the extreme over a longer period of time if the deficits are big enough. Given where we're starting from, I don't want to suggest that I think a rise in interest rates is inevitable, particularly in nominal terms. If we continue to make progress on inflation, even the current level of interest rates, in effect, becomes higher in terms of real impact; we are starting from a higher level.

Senator DODD. Would you suggest as a doctor might suggest that a little bit of medicine now might hedge or protect us from having to take a stronger dose later?

Mr. VOLCKER. In terms of the kind of immediate policy problems we find, I think if some action is necessary and desirable now to curb the threat of inflation rising later, and if that action is taken for a relatively small cost, to use that word, you will get a very large benefit in terms of the basic outlook for interest rates. You will create a situation in which you will maximize the chances of interest rates coming down in the future.

I fully accept the basic analysis that you gave earlier with a little different kind of twist, that sometimes a restraining action in the short run will be just the thing that's necessary to avert the risks of a much bigger rise in interest rates later. That's, of course, the kind of question we have to raise for ourselves right now, because—particularly with that deficit sitting out there—if we permit the inflationary process to get started again, we're clearly going to have higher interest rates and of some size.

Senator DODD. Thank you.

The CHAIRMAN. Mr. Chairman, Senator Tower was not able to be here for obvious reasons. He's managing the defense authorization bill on the floor. He had one question.

Small businesses are among the first in our economy to feel the impact of rising interest rates. What would be your opinion of the appointment of a representative of small business to the next vacancy on the Federal Reserve Board?

Mr. VOLCKER. I think the Federal Reserve Board ought to have a variety of backgrounds represented on it, including small business. That's a useful perspective. We've got seven members and there's a lot of variety in backgrounds. I don't like to think of any of them as representative of a particular group—small business or farming or banking or any other group. I don't think a particular group should feel that it has a vote in a direct sense on the Federal Reserve Board. But having people with those backgrounds is useful. I think a variety of backgrounds on the Board only adds to the realism of our discussions and sensible policy judgments.

The CHAIRMAN. I would agree with you. There are many suggestions before the committee over the last 2 or 3 years for representatives of particular groups and I don't know where that stops when you start that. I have been critical in the past of the lack of geographical representation and that the spirit of the law, if not the letter of the Federal Reserve Act, has been violated in the concentration of people who have spent a good deal of their life in Washington and they might have attended college in California and therefore that qualifies them for that Federal Reserve district. I would agree that I do think we need broader representation than possibly we have had in the past and certainly adherence to the geographical requirements of the Federal Reserve Act.

Mr. Chairman, we appreciate your patience today. We have been fortunate in not having any votes on the floor. The hearing will continue with additional witnesses on Chairman Volcker's renomination at 2 p.m. in the Banking Committee hearing room, SD-538. Also, next week, at the Humphrey-Hawkins hearings, Chairman Volcker will be back before us. With the approval of Senator Proxmire, it is my intention that at the conclusion of Chairman Volcker's testimony next Thursday that we will conduct a vote on the recommendation for his new term as Chairman of the Federal Reserve.

The committee stands in recess until 2 p.m.

[Whereupon, at 12:55 p.m., the hearing was recessed, to be reconvened at 2 p.m. this same day.]

[Biographical material on the nominee follows:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: VOLCKER (LAST) PAUL (FIRST) ADOLPH (OTHER)

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

Date of nomination: July 8, 1983

Date of birth: 5 (DAY) 9 (MONTH) 27 (YEAR)

Place of birth: Cape May, N. J.

Marital status: Married

Full name of spouse: Barbara Marie Bahnson Volcker

Name and ages of children: Janice L. Volcker Zima, 27
James P. Volcker, 25

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Princeton U.	1945-49	B.A.	1949
Harvard U.	1949-51	M.A.	1951
London School of Economics	1951-52	None	

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

Harvard Bus. School Club of NY & Wash.-Bus. Statesman Awards, 1983; Honorary degrees: Hamilton College 1980; U. Notre Dame, 1980; Adelphi U., 1981; Fairleigh Dickinson U., 1981; Princeton U. 1982; Dartmouth C. 1983; New York U. 1983; Bryant College, 1983. Arthur S. Flemming Award; Alexander Hamilton Award; William F. Butler Award, Fellow, NABE; Tax Foundation Public Service Award, 1980; Bank Administration Inst. Medal, 1983; General Leslie Graves Award, MacArthur Medal, Phi Beta Kappa, Rotary Foundation Fellow, Administration Fellow (Harvard U.) etc.

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

Organization	Office held (if any)	Dates (approx.)
Council on Foreign Relations	B of D	1975-79
American Council on Germany	B of D	1975-79
American Friends of the London School of Economics	B of D	1974-77?
Rockefeller Foundation	B-Trustees	1975-79
American Red Cross Endowment Fund		1972-79?
Trilateral Commission	Member	1975-79
Mayo Clinic Foundation	B-Trustees	1979-present

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

Chairman, Federal Reserve Board, 8/6/79 to present

President, Federal Reserve Bank of New York, 8/75-8/5/79

9/74 to 7/75 - Woodrow Wilson School of Public & Int. Affairs, Princeton University (teaching)

1/69 to 7/74 - Treasury Department (Under Secretary)

1965 to 1969 - Chase Manhattan Bank, NY/V.P. & Director of Forward Planning

1962 to 1965 - Treasury Department/Dir. Fin. Analysis & Deputy Under Secretary

1957 to 1961 - Chase Manhattan Bank/ Financial Economist

1952 to 1957 - Federal Reserve Bank of New York - Economist and Special Assistant

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

Chairman, Federal Reserve Board, 1979 to present

President, Federal Reserve Bank of New York, 1975 to 1979

Treasury Department, 1969 to 1974 and 1962 to 1965

Federal Reserve Bank of New York, 1952 to 1957

Dept. of Commerce, Balance of Payments Adv. Comm. 1967-68

Advisor to Committee on Reorganization of the Government for Foreign Policy 1974-75

Dept. of State Review Bd. for Career Ministers (1975)

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

"The Rediscovery of the Business Cycle" 1978

Newspaper articles, reports, reprints of speeches, etc. on economic policy -- I have no listing.

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

None

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

None

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

Presently serve in position; see attached.

Future employment relationships:

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

   Not applicable

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

   No

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

   No

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

   I do not feel committed to do so.

Potential conflicts of interest:

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

   Pension rights from service at Federal Reserve Bank of New York

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

   None

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

   None

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

None, apart from contacts in connection with official duties.

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

None to my knowledge

Civil, criminal and investigatory actions:

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

None, apart from suits brought in connection with official duties.

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

None

Addendum to Volcker Statement

Qualifications

VOLCKER, Paul A. -- Sworn in August 6, 1979 to fill the unexpired portion of a term as a Member of the Federal Reserve Board ending January 31, 1992. Mr. Volcker was designated Chairman of the Board for a four-year term beginning August 6, 1979.

PAUL A. VOLCKER was born September 5, 1927, at Cape May, New Jersey. He earned his B.A. at Princeton University in 1949 and an M.A. in political economy and government at the Harvard University Graduate School of Public Administration in 1951. He attended the London School of Economics in 1951-52. Mr. Volcker's first association with the Federal Reserve System was as a summer employee at the Federal Reserve Bank of New York in 1949 and 1950. He returned to the New York Bank in 1952 as a full time economist, and remained with the Federal Reserve until 1957, when he became a financial economist at Chase Manhattan Bank. In 1962 Mr. Volcker joined the United States Treasury as Director of Financial Analysis and in 1963 he became Deputy Under Secretary of the Treasury for Monetary Affairs. From 1965 to 1969 he was a Vice President of Chase Manhattan Bank. In 1969 he was appointed Under Secretary of the Treasury for Monetary Affairs, where he remained until 1974. During this time Mr. Volcker was the principal United States negotiator in the development and installation of a new international monetary system departing from the fixed exchange rate system installed following World War II. He spent the academic year 1974-75 at Princeton University as a Senior Fellow in the Woodrow Wilson School of Public and International Affairs.

Mr. Volcker became President and chief executive officer of the Federal Reserve Bank of New York on August 1, 1975. He continued in that office until he became Chairman of the Federal Reserve Board. As President of the Federal Reserve Bank of New York Mr. Volcker was a continuing Member of the Federal Reserve System's principal monetary policy making body, the Federal Open Market Committee. He was elected Vice Chairman of the FOMC August 19, 1975. As Chairman of the Federal Reserve Board Mr. Volcker is Chairman of the FOMC.

Mr. Volcker has received honorary degrees from Adelphi University, 1980; University of Notre Dame, 1980; and Fairleigh Dickinson University, 1981.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TRIBLE FROM PAUL A. VOLKER

In February before this committee, you stated that "over time the growth of money and credit will need to be reduced to encourage a return to reasonable price stability." You also said that financial stability "will require that we avoid excessive growth of money and credit because, sooner or later, that growth will be the enemy of the lower interest rates and stability we need."

How do those statements square with Fed policy which allowed M1 to grow 12.2 percent during the year ending in May, and now has M1 way above its target?

Recent institutional and behavioral changes have made it even more important to look at the behavior of money and credit aggregates as a group in assessing whether their growth rates are consistent with a return to reasonable price stability. Growth rates of M2, M3, and domestic nonfinancial debt are all consistent with their ranges, though their growth has picked up somewhat recently.

M1 is the only aggregate whose growth has run well above target. This has been accepted because of several factors. Looking at M1 itself, there has been continuation into this year of the very unusual, large decline in its velocity that developed last year. This decline in velocity, which may be abating now, appears to be related at least in part to the fact that NOW accounts--in effect interest-bearing checking accounts introduced on a nationwide basis at the beginning of 1981--have come to be an important component of that aggregate. As market rates declined sharply last year, the spread between interest rates available on NOW accounts and other outlets for liquid funds narrowed more than proportionately, apparently stimulating demand (with a lag) for NOW accounts relative to income.

Other factors may also have been important for a time, including the high degree of economic and financial uncertainty. You will recall that, because of these reasons, we indicated in our earlier testimony less emphasis would, for a time, be placed on M1 alone, and that the judgments about movements in the aggregate would need to be tempered by analysis of business and financial developments generally.

While the underlying trend in M1 may be shifting, that should be a more gradual process. We indeed should be alert to the probability that, cyclically, sizable increases in M1 "velocity," more in accord with historical experience, are likely. Consequently, we look toward substantial slowing of the recent rate of increase in the targets we will be presenting.

Taking account of the aggregates as a whole and institutional changes, I believe we are on a course consistent with encouraging a return to price stability over time--and we must remain so. The weight placed on M1 in particular will be reviewed regularly.

Since early May, long term interest rates have headed upward. Do you think that rapid money growth, and the failure to keep all money measures within their target ranges, has contributed to this by worsening inflationary expectations and creating uncertainty about what the Fed is up to?

I believe the recent rise in long-term rates reflects several factors. To help assure that growth in money and credit will remain consistent with progress toward price stability, in an environment of accelerated real economic growth, the posture of monetary policy has been slightly less accommodative in recent months; in other words, pressure on bank reserve positions has been increased to a degree. This in itself has been accompanied by some rise in money market rates, which often gives rise to some temporary sympathetic response in longer-term rates. The recent rise in long rates also appears to reflect the impact of the acceleration in economic recovery on actual credit demands, which were appreciable in the second quarter, and anticipation of further increases in the future. The potential conflict with continuing, large federal credit demands is, of course, a matter of great concern, and the speed of the economic recovery has tended to advance those concerns.

I do not exclude some influence from anticipations that more rapid monetary growth might induce <u>further</u> Federal Reserve actions to restrain money and credit growth. As that implies, in an expanding economy with heavy Treasury deficits, action to restrain money growth tends to increase market pressures, even though, in the long run, the effects on inflation and interest rates may be favorable. I also agree that considerable skepticism remains about the inflation outlook, but I would not single out recent growth in the aggregates as the principal or major source of new concerns.

Recent newspaper reports say that Administration officials want the Federal Reserve to restrain monetary growth through open market operations, but not by raising the discount rate. Do you agree with that advice?

Whether the Federal Reserve should raise the discount rate in the process of restraining money growth depends on many factors, such as probable "announcement" effects on attitudes in domestic and international financial markets as well as the more routine problems connected with effective administration of the discount window. But, basically, it depends on an assessment of whether a strong surge in demand for credit at the discount window by depository institutions, given the relation of the discount rate to market rates, is itself fueling excessive monetary expansion. If it is, the restraint on money growth from holding back on provision of reserves through open market operations--which is the fundamental means of controlling money--may need to be reinforced by discount rate action. That is a judgment that can be made only in the context of particular circumstances, taking account of overall economic and financial conditions. In most instances, over time, the tools are complementary.

What role does the international debt situation play in the Fed's reluctance to slow the growth of money and credit?

I have pointed to the debt problems of many countries in the developing world as one of the major threats to financial stability and to a healthy recovery of the U.S. and world economy. These problems are among the many factors that the FOMC takes into account in reaching decisions on the implementation of monetary policy. In the short run, increases in interest rates from any source or any slowing of economic growth does tend to complicate the problems of international finance, and that factor has been weighed by members of the Committee. Over time, however, I believe lower interest rates and sustained growth will depend upon success in containing inflation, and that consideration is a major element in policy.

Do you conceive of rapid money growth in the United States as a way to alleviate international debt problems?

No. The ultimate resolution of the serious international debt problems confronting the world economy today will depend in part on achieving a sustained, non-inflationary expansion of the U.S. economy. The contribution that U.S. monetary policy can make to such an expansion is to ensure that progress against inflation is consolidated and extended, which will require restraint on the growth of money and credit over time. In this context, rapid monetary growth in the United States would not long alleviate international debt problems. Indeed, excessive growth would ultimately exacerbate those problems if it were to contribute to a rekindling of U.S. inflation.

A number of suggestions have been made that there should be an independent audit of the Federal Reserve's finances and policies.

Would you support such an audit? Or is it unnecessary or redundant?

I believe that there are an adequate number of audits of the Federal Reserve. The System is already reviewed at several levels. An independent outside public accounting firm reviews the financial statements of the Board in accordance with generally accepted auditing standards. In addition, the U.S. General Accounting Office performs numerous audits of the Board and the Reserve Banks. These audits include reviews of various programs of the System including activities in the supervisory, consumer and pricing areas. In particular areas, such as "priced services" we ourselves have sometimes initiated independent reviews.

The Board also conducts annual examinations of the "accounts, books, and affairs" of each Reserve Bank in accordance with the provisions of the Federal Reserve Act. In addition, the GAO performs various special audits of the Federal Reserve as requested by committees of Congress.

Our monetary policies are, of course, continually under Congressional and public scrutiny and debate. Accordingly, I do not believe that there is any need for additional regular audits of the Federal Reserve.

AFTERNOON SESSION

The committee reconvened at 2 p.m., in room SD-325 in the Russell Senate Office Building.

The CHAIRMAN. The committee will come to order. We are continuing the hearings that started this morning on the renomination and confirmation of Paul A. Volcker to be Chairman of the Board of Governors of the Federal Reserve System.

We have three witnesses before us this afternoon: Mr. Warren J. Hamerman, chairman of the National Democratic Policy Committee; Robert E. Merrill, vice president, Virginia Taxpayers Association; and W. C. Smith, Pittsburgh, Pa.

Gentlemen, we are happy to have you before us. Mr. Hamerman, if you would like to begin.

STATEMENT OF WARREN J. HAMERMAN, CHAIRMAN, NATIONAL DEMOCRATIC POLICY COMMITTEE

Mr. HAMERMAN. Yes. Mr. Chairman, the argument has been made that it is necessary to reconfirm Paul Volcker as Federal Reserve Chairman on the grounds that he will be a symbol of stability for the international economy. I would argue that it is just the reverse, that the renomination of Paul Volcker could well trigger a world financial collapse.

VOLCKER POLICIES CAUSED WORLDWIDE DEPRESSION

To that end, I would like to read at the opening a telegram received late last night from Brazil addressed to the Senate Banking Committee, signed by the president of the Union of Engineers of the State of Rio de Janeiro in Brazil. It reads as follows:

> At a meeting held in Brasilia in the month of April, 93 unions representing 1.5 million workers in the Brazilian State enterprises condemned the accord with the International Monetary Fund in light of the damage that this represents for workers and for national sovereignty. At the moment when the United States Senate is deciding on the maintenance of Mr. Paul Volcker on the Federal Reserve Board it is important that we register our protest against the economic directives imposed by the American Government on countries such as Brazil.

It is signed Jorge Bittar, president of the Union of Engineers of the State of Rio de Janeiro.

I also received, addressed to myself to be read at the opening of my testimony, a telegram from the president and secretary general of the UTRABOC Trade Union in Colombia, in Bogota, Colombia. This telegram and message is from the Union of Workers of Bogota. It reads as follows:

> In the name of thousands of workers, we reject the policy of high interest rates which have caused poverty, misery and unemployment. We expect the nonconfirmation of Mr. Paul Volcker.

Signed by Pedro Rubio and Jorge Carrillo, the president and secretary general of UTRABOC in Bogota, Colombia.

These two gentlemen are also on the National Federation of UTC of trade unions in Colombia, which is the national trade union federation associated with President Belisario Betancourt of Colombia.

I also have with me, which I would request to be put into the record, telegrams from leading industrialists, trade union officials from the various nations in Western Europe, including West Germany, Italy, Sweden, and France.

One very special telegram is from France which is quite short, which I would like to read, from Gen. Revault D'Allones France, who is a member of the Committee of France and was an aide to Marshall Le Cler—the liberator of Paris alongside DeGaulle—during World War II. He has been a French military attaché in many nations of the world. He is the author of the report, "In Defense of Europe" for the "Europa list" of the RPR. His statement reads:

> I support the policy of President Reagan, in particular, for beam weapons. I am opposed to high interest rates for both civilian and military purposes in the United States and Europe. I oppose Mr. Paul Volcker's renomination.

The rest of the telegrams from abroad are from Spain, Sweden, Italy, trade unions, industrial leaders, and so forth; as well as statements from various officials throughout the United States, in particular, trade union officials, leaders of farm organizations who oppose the renomination of Paul Volcker, and as well the leaders of various minority organizations such as the NAACP and so forth who call upon the Senate not to confirm the renomination of Paul Volcker.

I would request that all of these be put into the record.

The CHAIRMAN. They will be. And your full statement will be placed in the record as well, each of you. We will place your entire statements in the record.

Mr. HAMERMAN. Excellent. Then if I may proceed just to give an oral summary of my testimony. I am speaking on behalf of Lyndon H. La Rouche, Jr., chairman of the advisory board of the National Democratic Policy Committee, who has a statement attached to mine, which I wish to put into the record as well.

The CHAIRMAN. It will be so entered into the record.

WORLDWIDE DEPRESSION COULD BECOME A CRISIS

Mr. HAMERMAN. Mr. La Rouche demands that Paul Adolph Volcker not be confirmed for a second term as Chairman of the Federal Reserve System, as I do as well in the statement which I am submitting, on the grounds of the national security of our Republic as well as the national sovereignty of our allies and trading partners in Ibero-America, Asia, Africa, and Europe.

All would be gravely threatened with the renomination of Paul Volcker. We are currently in the midst of a worldwide economic depression that at any moment could ignite into a full-fledged global financial crisis. Mr. Paul Volcker is the symbol of the cause of that worldwide depression.

He is so viewed by the nations of Ibero-America, Africa, and Latin America. He is viewed as a Malthusian mechanic who, if in the position of Federal Reserve Chairman, would institute policies which would cripple the economic well-being of those nations.

Most of the heads of state of Latin America have spoken out in the period from 1979 to the present and currently about the policies of Paul Volcker and how they have caused, helped to contribute causally to the current world debt crisis, which is beyond repair within the current confines of the existing world monetary system.

We are dealing with a crisis which, in aggregate, contains $840 billion in external debt from the developing sector nations. The nation of Brazil, one of whose leading trade union organization—I read from their telegram at the beginning—alone owes nearly $100 billion in external debt; Mexico, $80 billion. Ibero-America as a totality owes an aggregate of $320 billion in external debt.

These nations of the developing sector have all documented on record the damage done by the high interest rate policy of Paul Volcker, which he pursued beginning in 1979. They fear—just as fears were expressed during the Senate committee hearings this morning—the rumors that Paul Volcker may again raise high interest rates in and of itself could cause a collapse of the world financial system.

These rumors are being heard throughout the capitals of the developing sector nations as well as in Washington. Most of the nonalined nations, under the chairmanship of Indira Gandhi, over 100 nations, have had leaders over the past 6 months condemn the policies of high interest rates, how they've contributed to causing the world debt crisis; specifically, the policies pursued by Paul Volcker since 1979, as well as the policies of the International Monetary Fund which they oppose because of his conditionalities policies.

The institutions of the old world economic order would view the return of Paul Volcker to the Federal Reserve as a signal to impose an even greater round of brutal austerity conditions onto the developing sector nations. This would be unacceptable to the political leaders as well as the populations of those nations. And therefore, they are in the process of forming a debtors cartel. Most specifically over this summer period a debtors cartel among our Latin American allies is forming.

On the 24th of this month there will be a meeting in Caracas which will celebrate the 200th birthday anniversary of Simón Bolívar. Many heads of state of Ibero-American nations will be there. Also, the King of Spain will be there.

In the draft documents for that conference, language is now being composed to announce the formation of a coordinating committee of Latin American nations to deal with the external debt. There will be several other conferences held over the course of this summer. I note them in my written testimony.

In particular, on August 1 special representatives of every Ibero-American head of government will meet in Santo Domingo, the Domincan Republic, to formulate these policies. Then beginning September 5 the Inter-American Economic and Social Council, of the Organization of American States, begins its meeting in Caracas as well, where political solutions to the global debt crisis will be discussed.

Most recently, Indira Gandhi, on behalf of 100 nations at the UNCTAD meeting, the United Nations Committee on Trade and Development, called upon the conference for discussing a new global framework to the betterment and mutual advantage of both the nations of the North—namely, the advanced sector nations like the United States—and the nations of the developing sector to discuss an augmentation of world trade and a reorganization of the world economy. In their terminology, they are calling for a "new world economic order," to replace what Indira Gandhi correctly termed the current "neo-colonialist" system.

Lyndon H. La Rouche, Jr., has a specific plan which is known as Operation Juarez, which would allow for a reorganization of the debt of the Third World nations around augmenting economic production and foreign trade from the United States.

RENOMINATION WOULD CRUSH UNITED STATES AND WORLD ECONOMY

I believe that Paul Volcker will not pursue those policies and that most of the political leaders and institutions, be they trade unions or heads of state in the developing sector, know that Mr. Paul Volcker will not pursue those policies. Therefore, a renomination of Paul Volcker could be the signal to ignite that process which will lead to the developing sectors' dropping of the "debt bomb" sometime over the next period.

In summary, Paul Volcker will, if nominated, spend the next year or so in the position of Chairman of the Federal Reserve at a moment of great crisis, tension and strain to the international economic system.

I think under those conditions it is fair to ask whether or not Paul Volcker is a man who can be trusted at that time of great crisis which is pending for not only our Nation but for the governments representing the vast majority of the 4.5 billion humans on this planet. And I would say not.

Paul Volcker has publicly stated in 1979 in a public conference in London, England, "A degree of controlled disintegration of the world economy is a legitimate objective for the 1980's." I would argue that Paul Volckers' policies, since he has been the Federal Reserve Chairman, have competently implemented that particular "controlled disintegration" policy.

Furthermore, Paul Volcker has an entire career for that policy which my written statement summarizes, beginning in 1971 when as an under secretary of the Treasury he played a principal role in taking the dollar off of gold and convincing John Connally and President Nixon to take certain measures which created the Eurodollar market which led to world inflation.

Second, in 1979, as is well known, Paul Volcker created, through the high interest rate policies beginning in October 1979, the beginnings of an economic depression in the United States. That depression was then generated, transferred, in the collapse of our production and trade, to the rest of the world.

I think that Paul Volcker has a long track record as being on the scene at every principal point at which a major policy decision has been made which has, in fact, contributed to the current world financial crisis; and has played a role in making the wrong decision at each of these points.

He is the wrong man for a very great and important job, at the worst time imaginable, because of the shocks to the world economy which we can expect over the following period. No amount of bluffing on his part or anyone else's can avert the reality of this coming period.

Finally, I think I make a cogent argument in my testimony that there is also a national security element, in terms of the intentions of our adversaries; namely, the Russians, and Yuriy Andropov. On June 15 at the Central Committee Plenum in Moscow, Yuriy Andropov gloated about the dangers that the "capitalist economic system of the West" was undergoing, and outlined an entire strategy in the speech which is now publicly available—or excerpts are publicly available. Andropov outlined a strategy for exploiting those difficulties over the coming period.

Yuriy Andropov would wish to see as Chairman of the Federal Reserve an individual who had a proven record and would be viewed around the world as a man who would generate instability rather than solving the particular problems as they need to be solved at this point. Andropov would relish the reconfirmation of Volcker.

As Lyndon La Rouche demonstrates in the accompanying analysis in the written record, the great financial crisis which we are in may or may not be at best postponed a few months. There is no recovery; there is merely a hoax of a recovery, if one is proceeding to look at the state of the world economy as a whole, or indeed, our national economy, in terms of the basic sectors of our industrial capacity— machine tools and the agricultural sector.

Were Paul Volcker to be confirmed, the United States and world economy would not merely continue to shrink; the nationally sovereign finances of the U.S. Government itself would be threatened. The Swiss Bank for International Settlements has been demanding surveillance control to put the U.S. internal economy into order. As I referenced, Yuriy Andropov at the Central Committee meeting in Moscow also was basing a strategy on the fact that the United States would not have the ability to defend itself in a financial crisis.

Paul Adolph Volcker has mismanaged the United States to the point where our national security as well as the national sovereignty of most of the nations of the north and south are both threatened. A vote cast for Paul Volcker would be a vote cast against the fundamental principles on which our republic was founded and looked to as a temple of liberty and beacon of hope for all mankind.

My testimony in written form goes through these other elements. Thank you very much.

[The complete statement and telegrams from various nations follow:]

Testimony of Warren J. Hamerman

July 14, 1983

Before the Senate Banking Committee

Were Paul Adolph Volcker to be confirmed for a second term as Chairman of the Federal Reserve System, the national security of our republic, as well as the national sovereignty of our allies and trading partners in Ibero-America, Asia, Africa, and Europe, would be gravely threatened. We are currently in the midst of a worldwide economic depression that at any moment could ignite into a full-fledged global financial collapse.

The accompanying statement by Lyndon H. LaRouche, Jr. -- "LaRouche Opposes Volcker Reappointment" -- identifies how Paul A. Volcker wittingly helped to bring the world economy to its current miserable condition, as well as defines the precise plan of emergency action required to solve the global monetary collapse. Lyndon H. LaRouche, Jr. is the chairman of the Advisory Board of the 23,000-member National Democratic Policy Committee (NDPC), the founder of Executive Intelligence Review magazine, board member of the Fusion Energy Foundation, co-founder of the Club of Life and a prospective candidate for the Democratic presidential nomination. In August 1982 LaRouche authored a book entitled OPERATION JUAREZ which has been widely utilized by Ibero-American leaders in defining their current strategies.

The sovereign nations of the developing sector owe more than $840 billion in external debt; our Ibero-American hemispheric allies alone owe well over $300 billion of that debt. At the same time, the advanced sector nations -- the United States, Western Europe, and Japan -- have an aggregate unemployment of well over 30 million and an unutilized manufacturing and agricultural capacity in the 30-35 percent range. World trade is drastically collapsed.

Above all, PAUL A. VOLCKER MUST NOT BE REAPPOINTED FEDERAL RESERVE CHAIRMAN ON THE GROUNDS OF NATIONAL SECURITY. The renomination of Paul A. Volcker threatens our national security on two principal counts: (1) Volcker's "Controlled Disintegration" policy for the economy of the United States and our allies is exactly Yuri Andropov's strategic orientation to "collapse capitalism"; (2) Volcker's contingency plan for dealing with the debt crisis is to give up U.S. national sovereignty over our banking system and place the U.S. banking system as a "backstop" of last resort for the Swiss-controlled Old World Economic Order and its institutions.

Brazil's imminent default against the Bank for International Settlements may plunge us into the crisis before most of us expected. This is the last phase of a process that Paul Volcker set in motion in October 1979. Mr. Volcker, as you recall, flew home from an International Monetary Fund conference to "save the dollar" by raising interest rates; as I will show, the collapse of the dollar then was the result of policies which Mr. Volcker had put in place years earlier, and his plan to "save the dollar" in 1979 has bankrupted our debtors and will shortly bankrupt us.

The Old World Economic Order, centered in Swiss control of the corrupt institutions of Fritz Leutwiler's Bank for International Settlements (B.I.S.), the International Monetary Fund (I.M.F.) and World Bank, is bankrupt and financially beyond resuscitation. When Paul Volcker hiked U.S. interest rates to usurious levels in October 1979, other nations were forced into increased rates and borrowing charges as part of a desperate attempt to "paper over" the corpse of the Old World Economic System.

Paul A. Volcker's notorious high-interest rate policy at the U.S. Federal Reserve has ballooned unpayable debt obligations to astronomical levels. Brazil's debt alone converges on $100 billion, followed by Mexico ($80 billion), Argentina and Venezuela in the $40 billion range, and Chile (approximately $30 billion.) Virtually every head of government among our Ibero-American allies has denounced the high-interest rate policy of Paul Volcker as having catalyzed this world debt crisis. Indira Gandhi of India, the chairman of the Movement of Non-Aligned Countries numbering more than

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100 nations, has identified the fundamental fact that without an economic recovery of the nations of the South there can be no recovery in the North, and that the debt question is central to achieving such a true prosperity.

The monstrous magnitude of the world debt overhang, completely overwhelms the recent media hoax about a U.S. economic recovery. The so-called economic "upswing" has been caused by cut-rate auto loans and a temporary increase in supply of medium-priced mortgage money for construction. Mr. Volcker and Treasury Secretary Don Regan have shifted the illiquidity of the private sector onto the Federal budget, with a $100 billion per annum rate of issuance of off-budget mortgage bonds and similar chain-letter devices. As interest rates, inevitably, continue to rise, the chain-letter recovery will fold up. However, the collapse in U.S. capital goods and agricultural sectors -- as even the U.S. Commerce Department has been forced to admit -- far and away floods out the statistical rises in the auto and construction sectors.

How Volcker Caused the Debt Crisis

The resolution of the debt crisis begins with understanding how Paul Volcker's policies helped to cause this crisis. In fact, approximately $200 billion of Ibero-America's $310 billion foreign debt is the result of Volcker-regulated usury, capital flight, and declines in trade. Nearly two-thirds of all Ibero-American debt has nothing to do with any spending or development at all, in the same way that the debts accumulated by American farmers over the past few years have nothing to do with increased investment in agricultural development. Instead of extending "hard" credits for production, only non-income-generating "soft" loans for debt service have been given. Now the international institutions threaten to "foreclose" on entire nations.

The American decision to float the dollar and suspend gold backing for U.S. foreign payments in August 1971 taken by then Treasury Undersecretary Paul Volcker and enforced by George Shultz, Treasury Secretary after 1972, created an unregulated banking pool of nearly $2 trillion. This so-called Eurodollar market put a permanent floor under interest rates, siphoned credit away from production and into speculative channels, and provided means for looting of "flight capital" from the economies of developing nations.

When Volcker drove the United States' federal funds rate, which stood at 8 percent, up to 14 percent in October 1979, the discount rate and hence the prime rate was forced up from the 5-7 percent range to the 20 percent range. Other nations were forced to raise their rates -- on penalty of suffering massive runs on their currencies and flight-capital operations -- as investment funds otherwise shifted toward the U.S. to take advantage of the relatively higher money market rates. Ibero-American economies paid $114 billion in interest charges alone between 1979 and 1982. More than 80 percent of all short-term debt contracted since 1979 and an increasing share of long-term debts have been contracted solely for the purpose of rolling over past obligations and meeting the debt service costs of Volcker's policies. As Volcker then contracted credit deployment to industry and agricultural investment in the United States, an industrial depression was begun.

The Old Institutions Are Bankrupt

Depression in the United States and Europe meant shrinking markets for raw materials and other exports of developing sector nations, in particular. The U.S.A. alone absorbs 42 percent of developing sector manufactures exports. The resulting collapse of developing sector economies -- undergoing an asset-stripping austerity through the infamous "conditionalities" of the I.M.F. -- shut off any potential markets for U.S. exports, in turn. Thus, during the Volcker years, U.S. output of tangible wealth collapsed an average of 6 to 10 percent per year. The developing sector nations were forced to finance at ever increasing short-term roll-over rates. During the summer of 1982 the debt payments crisis erupted into public knowledge around the Mexican situation.

Now the debtor nations are, in fact, in default on their financial obligations to Swiss, London, and New York banking houses.

The bankrupt institutions of the Old World Economic Order have a conscious policy toward the developing sector countries -- deploying upon them the "Four Horsemen of the Apocalypse": war, famine, pestilence, and death. The racist genocide policy of I.M.F. conditionalities is designed to "reduce the dark-skinned populations" of the world. The infamous "Global 2000" Policy of the Carter Administration was the population control correlative of Volcker's "Controlled Disintegration" financial policy.

The day-to-day brutal reality of this policy is what is propelling the leaders of the developing sector into concrete actions. They know, and the international financial institutions know, that any collective or chain-reaction default totaling several hundreds of billions of dollars in developing sector debt would be sufficient to bring $1 to $2 trillion in worthless international financial paper crashing down.

Paul Volcker is lying when he argues that only his renomination and contingency plan to "buy up" the bad loans of the developing sector can avert a world financial crisis. In fact, his renomination is guaranteed to trigger a world banking collapse under conditions unfavorable to the United States. In fact, the renomination of Paul Volcker is looked upon extremely negatively by the Ibero-American leaders who are now determining whether or not to drop the "Debt Bomb." A U.S. Senate vote for Paul Volcker could well be the trigger for the Debt Bomb.

The one orderly planned solution to the debt crisis is the LaRouche Plan of Action, which reorganizes the debt of Third World debtors as part of an agreement to build infrastructure projects in their economies and create the institutions of a New World Economic Order. Volcker has been a principal saboteur of such orderly solutions as are now immediately upon the agenda.

Debtors' Cartel Is Forming

On July 24 in Caracas, Venezuela, on the occasion of Bolivar's 200th birthday anniversary, the presidents of six leading Ibero-American nations and the King of Spain will meet to announce what is expected to be a continent-wide coordinated strategy for dealing with their debt. In a preparatory meeting just held in that same city by the Congress on Latin American Political Thought, the basis was laid for declaring a LATIN AMERICAN COORDINATING COUNCIL ON FOREIGN DEBT and establishing an Ibero-American Common Market as a defense against the Leutwiler and International Malthusian Fund (I.M.F.) policy of forcing the "foreclosure" of entire nations through head-to-head confrontations. On August 1, special representatives of every Ibero-American head of government will meet in Santo Domingo, Dominican Republic, to elaborate these policies. Then, beginning September 5, the Inter-American Economic and Social Council (C.I.E.S.) of the Organization of American States begins its meeting in Caracas.

Members of the U.S. Senate, if you were to reconfirm Paul Volcker as chairman of the Federal Reserve you would be placing the very symbol of the world financial crisis in the driver's seat at the moment that the front wheels of the car edge off the cliff.

The National Security Question

In 1979, shortly before President Carter appointed Paul Volcker, Volcker stated in London at a Memorial for British economist Fred Hirsh: "A DEGREE OF CONTROLLED DISINTEGRATION OF THE WORLD ECONOMY IS A LEGITIMATE OBJECTIVE FOR THE 1980s." This policy was described in a series of reports compiled during 1975 and 1976 by the New York Council on Foreign Relations under the title "1980s Project."

On June 15, 1983 Yuri Andropov gloated before the Central Committee plenum in Moscow that the world of capitalism was experiencing an uncontrollable economic and social disintegration crisis. It has been officially stated Soviet policy, beginning with Patriarch Pimen of the Russian Orthodox

Church and subsequently reiterated by Andropov and the KGB, to "roll back" President Reagan's proclaimed new strategic doctrine of March 23, 1983 -- the doctrine of "Mutually Assured Survival" through the research and deployment of new laser and other energy beam defensive systems capable of "beaming the bomb" or shooting down enemy missiles in flight.

Paul A. Volcker's policy of "controlled disintegration" of the American and world economy makes the implementation of President Reagan's March 23 policy impossible. <u>Defense spending has not caused our budget deficit</u> -- Volcker's policies did. For each one percent rise in interest rates, it has been shown that $5 billion is added to the federal deficit, on account of higher pay-out rates for Treasury bills, etc. The effect of the abrupt rise in the prime rate under Volcker was devastating on federal finances. Usurious interest rates also meant a rapid shrinkage of the federal tax base, due to multiplying unemployment and contraction or shutting down of farms and factories. The government began paying out more, even as it took in less.

In a typical lie, Volcker, whose high interest rates under Carter are largely responsible for the way the federal deficit has mushroomed out of control, has been a leader of the faction which demands that the President slash spending to "balance" the budget. Members of the Senate, will you buy the argument that an American "Unilateral Disarmament" would erase the deficits?

Volcker's policies have already significantly eroded the industrial base of the U.S. economy, the foundation of our national security. Industry has been run into obsolescence and collapse, especially our machine-tool industry and our basic industries. We are down to about 100,000 full-time family-operated farms, facing a food crisis. Our basic economic infrastructure has collapsed: water-management (ports and inland waterways), energy production, transportation and the basic infrastructure of our cities have fallen into decay. As Lyndon H. LaRouche, Jr. has emphasized, over the post-war period as a whole the percentage of our labor force employed as operatives in agriculture, manufacturing, mining, construction and transportation has shrunk from 62 percent in 1946, to about 25 percent in 1983.

A World War II war production mobilization, FDR-style but without the war, around the crash development of laser and other energy beam defensive systems can get our nation out of the "Post Industrial Society" mess it has been subjected to. As Yuri Andropov knows, with Paul A. Volcker as Federal Reserve Chairman such a policy can never be implemented. I assure you, members of the Senate, that Yuri Andropov will smile in gratitude at each of you who casts a vote for Volcker's renomination.

In the great strategic crisis phase we are entering, the Swiss old-money financial interests are in league with the

Russians. The oldest and dirtiest elements in world finance, the Nazi-linked Swiss and other Central European banking groups, expect that the collapse of the Third World debt will lead to the collapse of the American dollar and the debt of the United States government itself.

Furthermore, the more than $800 billion in developing sector debt now threatens to explode. Is Volcker's policy to protect American national security? No. Volcker's priority is to preserve the institutions of the Swiss-controlled Old World Economic Order. At a Washington meeting of the Swiss Bank of International Settlements in July 1982, Volcker worked out dollar "swap" arrangements, whereby the Fed, in the event of a crisis, would pump billions into the $1.7 trillion Eurodollar markets to bail-out international speculators based in "offshore," crime-infested money centers.

Volcker Is Incompetent

With Volcker in control, the principal weight of any financial crash will fall upon the people of the United States. The principal creator of the "Eurodollar bubble" in the first place is none other than Paul A. Volcker. In 1971 then Undersecretary of the Treasury for Monetary Affairs Volcker convinced Treasury Secretary John Connally, who duped Nixon into taking the dollar off of gold on August 15. This allowed a previously negligible, unregulated "offshore" financial system called the "Eurodollar Market" to mushroom from $50 billion in dollar-denominated assets at the time to its current $1.7 trillion. By "floating" the dollar, the world's reserve currency, free of gold, Volcker gave the Eurodollar bankers the power to artificially create the "aroma" of money as commercial lending credits, and then denominate those fictitious credits as U.S. dollars. The Eurodollar funny money then began to flood the U.S. markets, generating monetary hyperinflation. Volcker's 1979 high-interest policy was the attempt of an incompetent surgeon to "correct" a man's limp by sawing off his other leg. Volcker "succeeded" in shutting off credit to U.S. industry and agriculture.

By the time President Reagan was in office, industrial output in the United States had fallen 8 to 10 percent overall. Volcker had reduced auto production 22 percent; reduced home-building 50 percent; reduced steel production by 10 percent; and caused American farms to go bankrupt at the rate of 2,000 per week. The Savings and Loan Institutions were caught in the vise of receiving an average of 8 percent income on home mortgages, while forced to pay out at the new high 15-20 percent rates. Then in March 1980 Volcker had a principal hand in deregulating the already shaky banking industry through the Monetary Control Act of 1980 that helped to "milk" local financial institutions. In October 1980 the

Federal Reserve authorized the establishment of unregulated "International Banking Facilities," bringing unsavory "offshore" banking practices "onshore."

At the same time Volcker and the Swiss imposed credit-squeezing policies on both the U.S. and other nations. In June 1982, Volcker told a Council of the Americas audience at the State Department that the International Monetary Fund, whose "conditionalities" have nearly destroyed many debtor nations' economies, should be given supranational powers to control international credit flows, forbidding any private bank from lending to Third World nations. This, combined with the stated policy of having the I.M.F. conduct "surveillance" or "putting-the-house-in-order" operations, would destroy the sovereignty of nations. On January, 27, 1982 Volcker demanded that the bankrupt I.M.F. be bailed out by the U.S. Congress, telling a session of the Joint Economic Committee: "Timely action by the Congress is essential to assure that I.M.F. resources are commensurate with possible need." Finally, in June 1983, as Volcker's colleague, Swiss National Bank president Fritz Leutwiler pushed Brazil into a confrontation, Volcker drew up secret contingency plans to deal with a debt collapse by having the Federal Reserve buy at or near par the "bad debts" of the large commercial banks and back these purchases up by nothing other than a spree of "hyperinflationary" Treasury printing, according to the authoritative weekly Executive Intelligence Review July 12, 1983. LaRouche has aptly called this "creative book-keeping methods."

As LaRouche demonstrates in the accompanying analysis, the "Great Crisis" may at best be postponed a few months. Were Volcker to be reconfirmed, the U.S. and world economy would not merely continue to shrink. The national sovereign finances of the U.S. government would be threatened. The Swiss Bank for International Settlements has been demanding "surveillance" control to "put the U.S. internal economy in order." Since the June plenum of the Central Committee in Moscow, the ability of the United States to defend itself in a financial crisis has become a principal feature of Soviet strategic calculation.

Paul Adolph Volcker has mismanaged the United States to the point where our national security, as well as the national sovereignty of most of the nations of the North and South, is threatened. A vote cast for Paul Volcker is a vote cast against the fundamental principles upon which our republic was founded and looked to as a "temple of liberty and beacon of hope for all mankind."

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LaRouche Opposes Volcker Reappointment

by Lyndon H. LaRouche, Jr.

I oppose the re-appointment of Paul Adolph Volcker as chairman of the Federal Reserve System. For practical reasons, I cast humility aside, to cite the evidence that I am the world's most accurate economic forecaster, and state that anyone who considers Mr. Volcker to have performed on behalf of the interests of the people of the United States does not know that the world and the United States are presently sliding downward in a general economic depression, and teetering on the edge of the worst international financial collapse in modern history.

Naturally, in his own fashion, Mr. Volcker has displayed a certain variety of competence. During the spring of 1979, prior to his nomination by President Jimmy Carter, Mr. Volcker publicly avowed that he was in sympathy with a policy which he described as "controlled disintegration" of the economy. That policy was described in a series of reports compiled during 1975-1976 by the New York Council on Foreign Relations, a series of reports entitled the "1980s Project," and later published in at least substantial part by McGraw-Hill under a grant from the Eli Lilly Endowment. In his functioning as Federal Reserve chairman since October 1979, Mr. Volcker has faithfully followed those specifications for disintegrating the U.S. economy, and has done that work with what may be described as "success."

It should be underlined in this connection, that the first of the regular LaRouche-Riemann quarterly forecasts for the U.S. economy, published in the international newsweekly Executive Intelligence Review during early November 1979, was dedicated to forecasting the effects of Mr. Volcker's policies upon the U.S. economy. That forecast of November 1979 has been accurate for the entire period to the present date. I must add that the LaRouche-Riemann quarterly forecasts have been the only regular forecasts published by either the federal government or private forecasting services which have been consistently accurate over the period since November 1979. Usually, forecasts published by other agencies have been proven more or less absurd when compared with later results.

On the basis of past performance, it can not be said that I did not forewarn repeatedly of the consequences of keeping Mr. Volcker in the position of Federal Reserve chairman.

The LaRouche-Riemann forecasts for late 1979 and early 1980 forewarned that Volcker's policies would push the economy of the United States through a double-dip recession, and then into a general economic depression. It was forecast that the first recession would become visible at the close of February 1980—exactly as this did occur. We forecast that a temporary leveling-off of the downward slide of the economy would occur over the fall, winter and spring of 1980-81, which did occur as forecast. We also forecast, also during 1980, that the second dip downward would erupt during summer and fall of 1981, which did occur. We warned that this would bring the world's economy to the brink of a full-fledged economic depression.

We entered a new worldwide economic depression at the beginning of 1982. Also as forecast, the world entered into a more or less permanent state of international financial crisis during the summer of 1982.

True, there are people who actually believe that an upswing occurred during winter 1983. What did occur was an upswing in building up a massive, unsold automobile inventory, which can not be sold off without lowering automobile manufacturers' production by a far greater amount than the temporary increase used to build that massive inventory-bulge. The truth is that levels of world trade in manufactured and agricultural goods have continued to collapse over this entire period, to the effect that whole groups among indebted exporting nations are in general no longer paying principal due on account of their foreign debts, and many have ceased also paying the interest payments due on that debt. They simply have no foreign-trade earnings to earn the currency needed to pay external debt.

A very substantial portion of the increased unemployment in the United States itself is the direct result of the collapse of the purchasing power of so-called developing-sector nations.

As a result of the situation in international affairs which Volcker's Federal Reserve policies have produced, the economy of West Germany is presently in a state of collapse from which it could never recover under present international monetary arrangements. Italy's economy is a corpse wandering looking for an undertaker—or a new Mussolini. France's economy is being driven to the brink of collapse. Denmark's debt-ratios are worse than those of most developing nations. Most OPEC nations are now operating at substantial net deficit, as a result of collapse of demand for energy-supplies. During the recent conference in Moscow, Soviet General Secretary Yuri Andropov gloated publicly over the prospects of Soviet world-rule being nourished by the results of Mr. Volcker's policies of "controlled disintegration."

It would not be unfair to describe Paul A. Volcker as Secretary Andropov's preferred choice for U.S. Federal Reserve chairman.

We have glanced at the highlights of Mr. Volcker's past performance. Let us look at the future.

The foremost fact facing the Executive and Congress of the United States is that we face an early international financial collapse whose first wave would wipe out between $1 and $2 trillion of financial values. Under present International Monetary Fund and Federal Reserve policies, such a break could collapse as much as three-quarters of U.S. savings and other banking institutions, a fact being viewed with cold-blooded amusement among leading Swiss banking circles.

When this financial collapse will occur can not be predicted, of course. When it might probably occur can be forecast. I explain the highlights of the situation.

Most nations of Ibero-America are at present in a de facto aggravated state of financial default. Should any of the world's banking-centers choose to do so, the Swiss Bank for International Settlements, for example, it has every legal right at this moment to declare most of those nations in default. Such action, which Swiss bankers have threatened to take repeatedly during the recent period, would collapse over $300 billion of the present external debt of Ibero-American nations. The collapse would fall chiefly upon the City of London.

Since summer 1982, nations have successively plunged into a state of de facto financial default. In an effort to delay a chain-reaction collapse of the international financial system, the U.S. government, the international monetary institutions, and the private banking systems, have resorted to methods most charitably described as "creative bookkeeping." This has consisted chiefly of loaning debtor-nations back their own unpaid IOU's at pyramided interest-charges. In other words, the international monetary and banking institutions have been playing the game of "pyramid club," constructing a hyperinflationary chain letter in unpaid and presently unpayable international debt.

This process, affectionately described as "debt rollover," came to the end of its first round at the close of the first quarter 1983. Then began the second round, whose governing genius was the fact that no matter how bankrupt a debtor is, he is never officially bankrupt until either he himself or one of his creditors declare him so. In other words, as long as none of the principal debtor-nations declared a debt moratorium, and as long as no official monetary agency or banking institution declared them in default, we might all stroll about whistling merrily, assuring ourselves that a solution to the debt-crisis was just around the corner.

We hear such things as, "you will see, Brazil will come to its senses, and accept IMF conditionalities, and then all will be back in order." What utter nonsense: the specific wisdom of the IMF's conditionalities policy is to offer nations loans for which the IMF presently lacks deposits, on condition that the nations in question collapse their production. This is like telling a bankrupt individual that he will only change his state of employment from full-time to part-time employment. The spectacle created by the present IMF president, Mr. de Larosière, does tend to make Mr. Volcker appear a towering pillar of economic sanity, if only by comparison.

Ah, but we also hear of an "economic upswing" in both the U.S. and West German economies, economic "upswings" which exist in fact only in the fertile imaginations of certain statisticians.

I call your attention to a series of dates, the closing financial booking-dates of June, July and August. Without bookkeeping tricks vastly more "creative" than those we have witnessed during the recent ten months, we can not get through those dates without the triggering of either a large-scale debtors' cartel or the alternative of chaotic financial defaults. One might hope it would be the former, since this would force an orderly international monetary negotiation, whereas individual nations' separate actions would produce nothing but uncontrolled chaos.

It is not technically beyond the realm of the possible that someone will push through something astronomically absurd in the way of "creative bookeeping methods," to put this bankrupt system through the remainder of 1983. Soviet General Secretary Yuri Andropov would have long-range strategic reasons to be most pleased if such an illusory, temporary solution were attempted. Such methods would collapse a great part of world-trade levels as presently exist. It would merely postpone, not prevent the collapse, and would trigger an international hyperinflation resembling that which struck Germany during the early 1920s.

Everything in the past performance of the Federal Reserve under Volcker's chairmanship suggests that his future performance in that office would assure us the worst possible outcome of the worsening crisis by which we are presently gripped.

Fortunately, a general financial collapse is not unavoidable. The United States recovered from a Great Depression through the mobilization of 1939-1943. If the lessons from that past experience are mastered, we can overcome the present disaster, even at this late date. The question is posed, therefore, whether or not Mr. Volcker would be a force of opposition to the methods we are obliged to launch. It is on this point that I now consider Mr. Volcker's reappointment potentially a strategic as well as economic and financial disaster for our nation.

I summarize, as briefly as possible, the two measures of action required to solve both the present economic crisis and also the international financial crisis. It should be clear that Mr. Volcker's past performance and stated policy-outlooks would make him in effect a saboteur of economic and financial recovery at the Federal Reserve System.

The Economic Problem

The essential economic problem of our nation is that since the inauguration of the so-called "Great Society" program, we have torn down our national research-and-development capabilities, and have effected no significant advance in our productive technology, except in the form of left-overs from research and development accomplished during the pre-1967 period.

The one exception has been the growth of the data-processing industry. However, the general use of data-processing investment has been in areas of application of administrative clerical procedures, where computers have assisted us in counting more easily the effects of unchecked collapse of the manufacturing, construction, energy-production, and agricultural sectors of the economy. In terms of the productive powers of operatives employed in either transportation or production of industrial and agricultural goods, we have progressed into stagnation and presently decline. In terms of physical output of production per member of the adult labor-force, or the population as a whole, the true dimensions of the problem become clearer.

The liquidation of employer-firms and farms in transportation, mining, manufacturing, construction, and agriculture are more immediately noticed. What tends to be less noticed is the erosion of basic economic infrastructure, built up during previous decades, chiefly before 1967, but now collapsing. This includes our basic mass-transportation infrastructure in categories of freight, inter-city and intra-city transport, our energy-production, our water-management-systems, our harbors, our inland waterways, and the basic economic infrastructure essential to industrial employment in our cities. It is proper to think of such basic economic infrastructure as analogous to a farmer's improvement of his acreage; without those improvements, the fertility of the farm collapses, to the degree no skill or diligence in other aspects of farming can repair the damage done.

At present, there is no prospect for repairing the accumulated damage done to our basic economic infrastructure. The budgeted levels of maintenance collapse year by year, as also the number of high-technology workplaces in service for production of physical output contract. We are well down the road toward economic Hell on this account. We are relatively worse off today than we were at the end of the 1930s Great Depression in 1939, and the new economic depression has only recently begun.

The deceptive feature of this decline is the social effect of a shift toward what is called variously a "post-industrial society" or "technetronic society." In 1946, we employed 62 percent of our total labor force as operatives in industry, transportation, and agriculture. Today, less than 25 percent of the available national labor force is so employed. That ratio of overhead costs to direct production costs has shifted from 38/62 to 75/25. That has been the principal economic cause for postwar inflation, as distinct from monetary causes. However, this also means that the contraction of employment of operatives in industry, transportation, and agriculture, has less political weight in the minds of the population and political parties than during earlier decades. The result is, that whereas we have already a deepening economic depression in our goods-producing sector, the slower rate of employment in administrative and service categories causes us to be less politically sensitive to the underlying realities than the population and government would have been during earlier decades.

Buried within this overall picture, there is another set of economic facts ominous for our nation's future. The economic strength of a modern nation depends upon relatively high and rising ratios of employment and investment in capital-goods production relative to consumer-goods production. It is the turnover in the capital-goods sector which limits the rate of growth of technology and per capita productivity in all sectors.

Into the 1974 period, the dangerous long-term trends were covered over by high levels of consumption of output of basic industries such as steel, by investments of agriculture and construction, as well as the crucial automotive sector. The collapse of the automotive sector brought the accumulated rot to the surface: our nation's basic industry, like that of Western Europe, is now dying at accelerating rates of loss of in-service capacity and accumulated obsolescence.

Under what might be considered as ordinary or normal arrangements, no recovery of the U.S. economy would be foreseeable over the indefinite future. The rate of investment which we might generate potentially, on the basis of existing levels of technology, would not be sufficient to match the general rate of continued collapse of combined industrial and agricultural investments, and of basic economic infrastructure. Without a massive injection of very advanced productive technologies, no recovery of the U.S. economy is conceivable even under the most favorable conditions of long-term credit-issuance.

What will cause a recovery, if anything causes it at all, will be the spillover of beam-weapon and related technologies into the civilian economy. The use of high-powered lasers as machine-tools exemplifies the point to be made. By building up an oversized capital-goods sector around the development and deployment of strategic ABM defense-systems based on these new physical principles, a doubling or even trebling of U.S. per capita output over the remainder of this century is an eminently feasible objective.

Such an economic mobilization will require both a large-scale generation of new, long-term credit at low-interest-rates, and a selective steering of the greater portions of primary issues of such credit, at very nominal interest-rates, into both defense and civilian industries, as well as injections of advanced technologies related to the defense effort within the civilian goods-producing sectors.

This effort will pay for itself, in terms of governmental budgets, if we focus attention on the way in which the federal, state, and local tax-revenue base is expanded by such a forced-draft recovery. We shall require investment-tax incentives which are fairly generous, but we must at the same time increase the tax-revenue basis to offset this as well as reversing present trends in budget-deficits. The expansion must occur in such a way that the larger average tax payments per capita are not a net burden, relative to present taxpayers' burdens.

Some will describe this as a return to a "military economy." We have a choice between deploying methods which some abhor as "military economy," and enjoying the continuing plunge into economic Hell.

In any case, we are presently in a strategic situation comparable to approximately that of 1938. I believe that actual war can be avoided, most probably, but it will not be avoidable unless Moscow comes to the negotiating table prepared to negotiate on the basis of the President's long-range U.S. strategic doctrine. The Soviet leadership will not negotiate on a workable basis until it is convinced that our commitment to implement the President's doctrine within as brief a period as five years is firm and efficient. Once they are convinced that we are going to survive as a leading economic and strategic power for the remainder of this century and beyond, they will finally recognize that they have no sane choice but to go to war or negotiate on that basis.

It is true that military goods can not be consumed generally as civilian-economy goods. For that reason, military expenditures have the form of economic waste. However, let us look at the military-goods output of our laboratories and industries as analogous to expenditures for a massive research-and-development effort. What we must measure is not the price of the military goods as such. What we must measure is the benefit spilling over into the civilian economy in the form of new high-technology investments which would not otherwise be possible.

We require, most urgently, a strategic ABM defense-system to free our nation from the nightmare of thermonuclear threat. However, beyond that, what we require is economic strength.

including the means to provide fruitful employment, and also acceptable conditions of life for our young and aging, as well as the working-age population.

We require that our monetary institutions be in tune with the strategic and vital other interests of our republic at this dangerous juncture. Where, in your hearts, do any among you believe that Paul A. Volcker stands on these matters?

Financial Reforms

The solution to the present international financial crisis is elementary. It has two parts. First, we require agreement to convert the presently overhung debt-balances of debtor nations into long-term, negotiable financial assets. This requires only the change of present financial obligations for suitable issues of long-term, low-interest bonds, issued by either the governments or central banks of the debtor nations. Second, to ensure the future ability of those nations to pay due amounts on such bond-issues, we must aid them in increasing their output and world-market earnings, through new issues of long-term, low-interest credit issued specifically for those categories of combined agricultural, industrial, and infrastructural investments which will assure the needed increase of the debtor's ability to pay.

This requires a rigid system of fixed exchange-rates among currencies, disciplined by a gold-reserve basis in relations among governments and central-banking systems. Pricing of replacement monetary-gold at its true market-value for production of required added amounts from mines, must be adopted for this purpose. In some cases, where existing currencies are in hyperinflationary disorder, a currency reform resembling that of President de Gaulle's heavy-franc measures must be instituted, together with measures of capital-flight and exchange-controls, to ensure that monetary speculation does not once again foster disaster of the sort experienced under the floating-exchange-rate system we have suffered since August 1971.

This is a matter which could not be resolved by the existing monetary order's institutions. The present financial crisis is beyond anything manageable by the private banking system, by central banks, or international monetary institutions as they are presently constituted. They have failed consistently for a dozen years, and will continue to fail; the failure is a built-in feature of their present policies and composition. This is a matter which can be solved only by action of the governments of sovereign states.

We can and must put a lid on monetary inflation, but this will require what some will lament as draconian actions taken in common among governments. The measures required could be implemented during the coming weeks, if the will to do so were available.

I must report that my proposals to this effect are widely circulated among governments and other influential institutions in many parts of the world, as illustrated by the wide circulation of an August 1982, book-length treatment of the Ibero-American case, *Operation Juárez*. Henry Kissinger and our State Department have thus far been opposing this even to the point of deploying some rather extraordinary, and sometimes legally irregular measures. Nonetheless, as the resolutions of the recent Non-Aligned Nations meeting at New Delhi, India, attest, the prevailing disposition among governments of the developing nations is for a government-to-government reorganization of the international monetary order. There is no politically practicable solution available except this approach.

This general monetary reform is needed to defend our nation's banking-system, now massively overexposed to the debt crisis, from a potential chain-reaction collapse. This measure is also urgently required strategically, both for political reasons, and for economic reasons. We urgently require a vast expansion of the capital-goods markets potentially represented by developing nations; otherwise we can not provide the needed economic recovery at home the breadth and depth of market required to sustain it.

In your hearts, I am certain, you have no doubt where Paul A. Volcker stands with respect to such urgent measures.

Let us put our nation back to work. The best way to assist that, is to put Paul A. Volcker out of work, at least out of employment by our Federal Reserve System.

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A Programmatic Policy for Recovery

by Lyndon H. LaRouche, Jr.

During the 1979–1980 period of the campaign for the 1980 presidential nomination, the Democratic candidate LaRouche issued a series of programmatic proposals, together with analytical prognoses for the consequences the nation would suffer if such remedies were not adopted. If we, today, compare the programs and prognoses of the various candidates for the 1980 presidential nomination, honest men and women will agree that the LaRouche prognoses were correct, and the competing prognoses flatly wrong.

In principle, nothing need be changed today in the proposals offered during 1979–1980. Only a few points need be added, to bring the proposals up to date with the problems which have been added to our national repertoire of daily agony since.

We reduce the essential proposals for action now—not waiting until January 1985—in the form of identified points of legislative and related action by our Federal government. After listing summaries of each such proposal, we conclude with relevant comments in summation.

The U.S. Bank Act of 1983–1984

A single act of Congress, in accordance with Section I, Articles §8 and §9, transforming the Federal Reserve System in entirety into the *Third Bank of the United States*.

1. **The Federal Reserve System is "federalized,"** made a subsidiary institution of the Executive Branch of the Federal government, subject to the inalienable constitutional powers of the Congress.

2. **Limitations on Bank Lending.** No banking institution which is or has been formerly a member of the Federal Reserve System, shall make any new loan, except as a renewal of an existing loan, which is in excess of its actual deposits of currency plus specie, less required reserves.

3. **Creation of Credit.** The only means for creation of new volumes of lendable credit by banks within the territories and possession of the United States, shall be the issuance of gold-reserve-denominated-currency-notes of the Federal Treasury of the United States. Each issuance shall be authorized by an Act of the Congress, and such notes shall be placed in circulation through the rediscount functions assigned to the Third Bank of the United States.

4. **The Rediscount Function.** The Third Bank of the United States (the "federalized" Federal Reserve System), shall employ new issues of Treasury currency for rediscount action only against new individual loan-agreements, for which the specified and restricted application of loaned funds is consistent with both general principles of prudence applicable to any bank loan, and according to lists of categories of approved types of loans eligible for such rediscount-treatment.

5. **Loan-Agreements Approved for Rediscount.** Except for such purposes of national defense or other national emergency, as authorized by Act of the Congress, all rediscounting of loan-agreements with use of new issues of Treasury currency shall be for investment in such forms of improvement and expansion of public and private ventures as increase the per-capita production of tangible goods of the nation as a whole.

6. **Loan procedures for Rediscount.** In the case an individual loan-agreement is approved for rediscount participation by the Third Bank of the United States, the authorized disbursements officer of that Bank shall draw a check against the issue of Treasury currency authorized to be distributed for this purpose. The sum advanced by means of this check shall bear a prime charge of not less than 2 percent and not more than 4 percent per annum. Ordinarily, this check shall be issued to a private bank which is a corresponding bank of the Third Bank of the United States, and that corresponding bank shall be authorized to make a reasonable service-charge for administration of the Third Bank's part of the total loan-agreement on account of which such disbursement is made.

Comments

This proposed Act:

(a) Eliminates the intrinsically monetary-inflationary "Keynesian multiplier" from the operations of the banking-system as a whole.

(b) Implicitly obliges the U.S. Federal Government to issue new volumes of lendable currency, adequate to the indicated classes of increased borrowing-requirements of the U.S. domestic economy and its export-activities in connection with tangible-goods production. This "compensates" the economy for the sharp constriction of lending-power caused by condition (a).

(c) Restricts the main flow of newly created credit, either to the national defense, or to investments in infrastructural or agro-industrial tangible-goods production investments at competitive levels of technology. It limits loans for other applications to lending-power generated by deposits of currency placed physically with private banks. The included objective is to shift the composition of employment of the labor-force from a 28 percent employment of productive operations to the range of between 40 percent and 50 percent over the remainder of the century.

(d) Allows unlimited expansion, provided it occurs in a climate of advancing technology, and under the impact of the credit-expansion and lending stipulations of this Act is counterinflationary within the limits of impact of national defense spending. It is therefore, also, implicitly a full employment Act.

The U.S. Tax-reform Act of 1983–1984

1. **General Purpose of Tax-Reform:** (a) To exterminate taxable-income advantages from parasitical investments in ground-rent, usury, and monopolistic forms of commodity-price speculation; (b) To afford preferred tax-treatment to such portions of private savings and corporate profits which are invested in the manner stipulated for rediscount-action by the Third Bank of the United States; (c) To shift the burden of taxation from the basic income of households to parasitical forms of capital-gains income associated with ground-rent, usury, and commodity-price speculation.

2. **Personal Income-Tax of Households.** To increase the per-capita exemption of income of households step-wise to $5,000 per annum.

3. **Investment-Tax Credits.** To provide tax-credits for investments in technologically-progressive production of tangible goods and infrastructural improvements bearing upon the production and transportation of such goods, and to extend these benefits to the household saver and private lending-institutions—in ratio to paid-in balances of the investment in which they share. This investment tax-credit provision shall replace capital-gains treatment except for the case of realization of inventions and research-and-development.

4. **General Taxation.** The operating budget of the Federal Government, as distinct from the capital-investments budget, should be balanced. A general, graduated income tax adequate to this purpose, adapted to the afore-listed conditions, shall be drafted to meet this requirement.

National Infra-Structure Projects Acts

1. **General Purpose of Acts.** These acts shall establish or refurbish Federal Authorities in such areas of either public works or privately-held public utilities, which bear directly upon the following categories of infrastructure:

2. **National Fresh-Water Supplies and Management.**

3. **National Transportation:** including canals, harbors, railways, and Federal highway systems, and interfaces and warehousing functions providing the interface among modes of transport.

4. **National Energy-Production:** especially facilitating completion of nuclear-energy and related high energy-flux density generating modes, with Federal override over costly impediments; giving priority to low-cost, long-term construction and permanent-financing loans for this purpose.

5. **Urban basic infrastructure.** Utilities, public transportation, and urban infrastructure for technologically advanced modes of tangible-goods-producing industries.

The U.S. Foreign-Banking Act of 1983–1984

1. **General Purpose of Act:** (a) To facilitate the establishment of a new international monetary system, based on gold-reserve relationship among states, and a system of fixed currency-values; (b) to provide for reorganization of debts of nations indebted to the U.S. Government or to financial institutions which are private institutions established within and according to the laws of the United States; (c) To protect the United States from unwholesome practices of foreign financial institutions.

2. **U.S. Currency.** Henceforth, the only form of lawful currency issued by the United States shall be gold-reserve-denominated U.S. Treasury notes. Imbalances on national account, involving this new issue of currency shall be resolved by gold-reserve transfers to nations which have entered into agreements to conduct their affairs in the same mode.

3. **Gold-reserve Value.** Monetary gold shall be priced at a market-price based on the price determined by cost-plus-profit by gold-mining, taking into account the volumes of gold bullion which must be produced.

4. **Reorganization of Foreign Loans.** If a debtor-nation shall require reorganization of its debt-balances, it shall issue gold-reserve-denominated bonds from a national bank based on the same principles as the Third Bank of the United States. These bonds shall be rediscountable security for authorized export-loans within the United States' banking-system, and shall be eligible for use of purchasing the old loans to be reorganized. The old loans shall cease to accrue charges after the cut-off date established for such exchanges by agreement of the Federal Government of the United States, and the bond-issues presented in purchase of the old loans shall be equal to accruals up to that cut-off date. The bonds shall bear a yield of between 2 percent and 4 percent per annum, on the basis of gold-fixed parity of currency in which the bonds are denominated.

5. **No foreign financial institution** which does not maintain the standards of banking specified for banks of the United States may acquire any part of the ownership of a bank doing business in the United States, and may not itself conduct business within the United States. Any foreign bank doing business within or sharing ownership of a bank established within the United States must provide full transparency of its total operations to bank-auditing agencies of the Federal Government of the United States.

These several Acts adequately outline the policy for recovery, otherwise explicitly or implicitly stated in preceding portions of this policy-memorandum.

What needs to be stressed is that the depleted infrastructure and goods-producing capacity of the U.S. economy prohibits a genuine, sustainable recovery unless investment-capital is contracted to a high degree in the most advanced capital-goods technologies, the same spectrum of technologies implicit in the development and deployment of a full-scale strategic ABM defense-system.

The following is the text of the telegram from the President of the Union of Engineers of the State of Rio de Janeiro, Brazil; accompanied by a translation:

CHAIRMAN
SENATE BANKING COMMITTEE
UNITED STATES SENATE
WASHINGTON, D.C.

EM ENCONTRO REALIZADO EM BRASILIA NO MES DE ABRIL, 93 SINDICATOS REPRESENTANDO 1,5 MILHOES DE TRABALHADORES EM EMPRESAS ESTATAIS BRASILEIRAS CONDENOU O ACORDO COM O FMI EM VIRTUDE DOS PREJUIZOS QUE ESTE REPRESENTA PARA OS TRABALHADORES E PARA A SOBERANIA NACIONAL. NO MOMENTO EM QUE O SENADO AMERICAN DECIDE SOBRE A MANUTENCAO DO SR. PAUL VOLCKER NO FRB, E IMPOTANTE REGISTRAR O NOSSO PROTESTO AS DIRETRIZES ECONOMICAS IMPOSTAS PELO GOVERNO AMERICANO A PAISES COMO O BRASIL.

ASSINADO
JORGE BITTAR
PRESIDENTE DO
SINDICATO DOS ENGENHEIROS NO
ESTADO DE RIO DE JANEIRO

CHAIRMAN
SENATE BANKING COMMITTEE
UNITED STATES SENATE
WASHINGTON, D.C.

AT A MEETING HELD IN BRASILIA IN THE MONTH OF ABRIL, 93 UNIONS, REPRESENTING 1.5 MILLION WORKERS IN BRAZILIAN STATE ENTERPRISES, CONDEMNED THE ACCORD WITH THE IMF IN LIGHT OF THE DAMAGE THAT THIS REPRESENTS FOR WORKERS AND FOR NATIONAL SOVEREIGNTY. AT THE MOMENT WHEN THE U.S. SENATE IS DECIDING ABOUT THE MAINTENANCE OF MR. PAUL VOLCKER ON THE FEDERAL RESERVE BOARD, IT IS IMPORTANT THAT WE REGISTER OUR PROTEST AGAINST THE ECONOMIC DIRECTIVES IMPOSED BY THE AMERICAN GOVERNMENT ON COUNTRIES SUCH AS BRAZIL.

SIGNED
JORGE BITTAR
PRESIDENT OF
THE UNION OF ENGINEERS OF THE
STATE OF RIO DE JANEIRO

Walter Boehnke, factory council and member of the Deutsche Angestellten Gewerkschaft (DAG, West-German white collar workers union)

As an active trade unionist in the Federal Republic of Germany I am shocked to hear that Paul Volcker is going to be appointed as the new chief of the U.S. Federal Reserve for another four years. We did not overlook here how the high interest rate policy conducted since 1979 ruined the international economy. It was Paul Volcker who started the policy of tight money and high interest rates. For us trade unionists this meant for the last four years that unemployment figures jumped up, that speedup increased and real wages decreased. We still remember quite well how in 1980 Volcker demanded to lower workers' living standards. No, there won't be an upswing with this man. The crisis will come to the peak while in the U.S. one has to take notice of the following: The Federal Republic of Germany is existentially dependant on the export of 40 % of her products. High interest rates strangulate trade between nations. For this reason I explicitly support Mr. LaRouche's plan for a reform of the worldwide monetery system and a global employment program in the framework of the New World Economic Order. LaRouche is perfectly right that nobody on this world has to starve if North and South would closely cooperate in technological "great projects" in agriculture, infrastructure and industry. Instead of Volcker's poverty program I support LaRouche's program for world development.

Werner Lampa, member of the West-German Metall workers Union (IGM) and No. 1 candidate of the EAP for the state parliament of Bremen.

As trade union representative in the North German ship building industry I can only be astonished: 35 years ago we succeeded with the help of the Americans to prevent the Morgenthau plan that would have meant the total demontage of German industry. Today the same evil of industrial razing comes back to us from the United States incorporated by Paul Volcker. His renewed appointment to the Chief of the U.S. Federal Reserve must not come through. For four years we were suffering from the results of his devastating high interest rate policy. I can legitimately claim that he is co-responsible for the loss of more than 50 % of the production capacitiy in the steal and ship building industry. As a trade unionist and politically active citizen I strongly support the way out of the world economic crisis presented by the program of Lyndon LaRouche. Worldwide and therefore also in Northern Germany this program is well-known as "Operation Juarez". This Program points out realistic ways how economic growth and full employment can be created in North and South.

(1) General Revault D'Allonnes France, member of Committee France and Its Army, Aide to Marshall Le Clerc, World War II, Military Attache in many countries, author of report, "In Defense of Europe," for the 'Europea list' of the RPR, in favor of development of beam weapons.

I support the policy of President Reagan, in particular, for beam-weapons. I am opposed to any policy of high interest rates, blocking productive investments necessary for both civilian and military purposes, in the United States and in Europe. I oppose Mr. Volcker renomination.

(2) Werner Dietrich, former First General Secretary, Metal Workers' Trade Union, Dortmund.

The present mass-unemployment in West Germany, in the steel industry of the Ruhr region in particular, and the associated contraction of the West German economy, is primarily due to Paul Volcker's high-interest rate policy.

I demand that the relevant U.S. authorities reject Volcker's renomination.

(3) Mr. E. Wenzel, factory council chairman of IG Metall (Metal Worker's Trade Union), Frankfurt West Germany.

In the name of my fellow workers, I oppose the renomination of Paul Volcker as chairman of the Federal Reserve because his interest rates policy has caused the collapse of West German export markets in the developing countries. Therefore, another four years of Volkcer's policies would the United States from supporting the New World Economic Order that our industries need so urgently.

July 12 (NSIPS)--The following message was sent today by the Union of Workers of Bogota and Cundinamarca (UTRABOC), to Mr. Warren Hamerman, Chairman of the National Democratic Policy Committee. Mr. Hamerman will read this message as part of his testimony against the reappointment of Paul Volcker as head of the Federal Reserve during Senate Banking Committee hearings this Thursday. UTRABOC is the largest labor union in the city of Bogota and the Department of Cundinamarca, Colombia, and is part of the UTC labor confederation.

"In the name of thousands of workers, we reject the policy of high interest rates which has caused poverty, misery and unemployment. We expect the non-confirmation of Mr. Paul Volcker."

Signed by
UTRABOC
Jorge Carrillo, President
Pedro Rubio, Secretary General
Bogota, Colombia
July 12, 1983

(4) Raphael Lune Gijon; Maria Teresa Tome de Murga, member Club of Life, Spain.

I am against the confirmation of Paul Volcker as Chairman of the Federal Reserve because of the negative effects of his actions on the world economy.

(5) Kurt Frankborn, Chairman of the Industrial Association "Utvekla Sverige" (Develop Sweden), with a membership of 500 firms. Mr. Frankborn is Executive Director of Hoegstad Aluminum in Mjoelby, Sweden.

As a Swedish industrial entrepreneur and as representtive of Swedish high-technology oriented industry, I oppose the high interest rate policy Paul Volcker stands for, a policy which has destroyed export markets for Swedish nuclear industry in countries like Mexico and Turkey, just to mention two examples. The high interest rate policy of Volkcer has also had a devastating effect on domestic industry, like our ship-yards, steel industry and pulp industry. Therefore, as Chairman of Utveckla Sverige, an association of small and middle-sized industry corporations, I think that to confirm the reappointment of Paul Volcker will be a catastrophic and disastrous decision for Swedish industry.

(6) Modesto Dematte, Italian Agriculture Trade Union, Come, Italy; recipient of the Medal of a Knight of Honor of the Italian Republic.

I believe there can be no farmer anywhere in the world who is not aware of the disastrous consequences of the high interest rate policies of Paul Volcker for the agricultural production of one's own country, and for world food supply. Such policies which destroy food production in a hungry world are as direct a cause of death as a bullet in the brain. I therefore appeal to the Congress of the United States to not confirm the renomination of Paul Volcker as Chairman of the Federal Reserve, and am convinced that Congress would thereby be lending the greatest possible support to President Ronald Reagan.

LABOR OPPOSES PAUL VOLCKER

"We, the undersigned trade union leaders, demand that the U.S. Senate move immediately to deny the confirmation of Paul Adolph Volcker as Chairman of the Federal Reserve. We further demand that the House of Representatives resolve as well to repudiate Volcker's policies which have destroyed both our industrial and labor resources.

"Now, Volcker would have the U.S. bankrupt our currency further by buying up the worthless financial paper of the major New York bank, as a chain reaction collapse begins over the next weeks or months.

"LaRouche's proposal to reorganize the debt to open up vast new markets for U.S. capital goods, including the sale of nuclear power plants, must be implemented now.

"Lane Kirkland and our national leadership must speak loudly and organize mass agitation to force Volcker out. Anyone who does not act forcefully to dump Volcker now is the friend neither of American Labor, nor of America itself."

Endorsers:

Wayland Cushman, Sgt.-at-Arms, UAW Retirees #148, Downey, California

Henry Martinez, Financial Secretary, Painters #1348, Los Angeles, California

Tom Simmons, President, IAM #946, Riverside, California

Eddie Peralta, Business Representative, Teamsters #986, Los Angeles, California

~~Marshall Wooten, Business Agent, Lumber and Sawmill Workers~~ #2288, Los Angeles, California

Marco Aguilar, Financial Secretary, Metal Polishers #67, Los Angeles, California

Corbett Bagley, Business Agent, Laborers #1184, El Centro, California

Claude L. Swigart, President, Building and Construction Trades Council, Southwest Michigan

J.T. Lewis, President, Building and Construction Trades Council, Jackson, Tennessee

Lucky McClintock, President, Central Kentucky Building and Construction Trades Council

Dwayne Brown, President and Business Agent, Carpenters #621, Brewer, Maine

Peter A. Risberg, Business Manager, IBEW #388, Stevens Point, Wisconsin

Kern, Inyo, Mono Building Trades Council, Bakersfield, California

Doug Zimmerman, Secretary, Kern, Inyo, Mono Building Trades Council, Bakersfield, California

Walter J. Scott, Business Agent, Carpenters #944, San Bernardino, California

Jim Wright, Business Agent, Boilermakers #732, National City, California

James M. Ryan, President, Steamfitters #101, Secretary-Treasurer, Building and Construction Trades Council, Memphis, Tennessee

Cordis Divas, President, Building and Construction Trades Council, Memphis, Tennessee

John W. Zerbe, President, Bricklayers #12, former secretary-treasurer, Building and Construction Trades Council, Flint, Michigan

W.B. Sanders, President, West Kentucky Building and Construction Trades Council, Paducah, Kentucky

Jim McManus, Business Agent, Plumbers #24, Summit, New Jersey

John Cleary, Secretary-Treasurer, International Brotherhood of Teamsters #892, Jersey City, New Jersey

Joe Chaneyfield, Vice-President, Service Employees International Union #305, Newark, New Jersey

Michael Marco, President, Building and Construction Trades Council, Delware, Greene, Ulster, Sullivan Counties, New York; President, International Brotherhood of Teamsters #445, Newburgh, New York

Dale Snyder, Business Manager, Bricklayers #11, Binghamton, New York

~~Ken Mulheisen, President, American Federation of Grain Millers~~ #36, Buffalo, New York

Anthony Inorio, Treasurer, Laborers #455, West Haven, Connecticut

Robert Keith, President, International Longshoremen's Association #1543, Jacksonville, Florida

George Elrod, President, St. Joseph Velley Building and Construction Trades Council, South Bend, Indiana

(organizational affilations for identification only)

FARMERS OPPOSE VOLCKER

Dear Congressmen:

"We urge you to oppose the $8.5 billion appropriation for the IMF and the reappointment of Paul Volcker as Chairman of the Federal Reserve Board. The policies of the IMF and the Federal Rserve, which bleed the real economy in the name of 'monetary stability' have brought on the Second Great Depression of the 20th century. Senate bill #24, sponsored by Walter Huyddleston (D-Ky) points the way to the solution of the international debt crisis by declaring a moratorium on the FHA farm debt in the U.S., Brazil. Mexico, and other Ibero-American countries are forming a debtors' cartel to force the same type of moratorium on the IMF.

"In the interest of national security, President Reagan should accept these moratoria and dump Volcker and the IMF.

"The U.S. can model its new North/South relations on the historical precedent set by Abraham Lindoln and Mexican President Benito Juarez.

"Therefore, the Senate should confirm as chairman of the Fed only a nominee who will accept these arrangements as a basis for new credit and monetary policies which promote capital goop3Eexports as the only means for economic recovery."

Patrick O'Reilly, farmer, Canby, Minnesota; Chairman, Minnesota National Democratic Policy Committee

Annabelle Bourgois, Baldwin, North Dakota; chairwoman of North Dakota National Democratic Policy Committee and former candidate for U.S. Senate

Joe Rolling, Arco, Minnesota, member, NFO; School Board of Arco

Dean Nichols, former president, Indiana NFO

Alan Cover, Kansas NFO National Director, Abilene, Kansas

Don Berdahl, farmer, Towner, North Dakota

Roger Wells, Axtell, Nebraska; NDPC Chapter Chairman.

Tom Kersey, National Chairman, Agriculture Policy Committee, Unadilla, Georgia

~~(organizational affilations for identification only)~~

MINORITIES OPPOSE VOLCKER

Proposed Resolution to Terminate Paul Volcker's Destructive Activities and Policies

"Paul A. Volcker has recently been renominated to be chairman of the Federal Reserve Bank for another four-year term by President Reagan. Volcker, over a three and one-half year period, has insittuted a policy of keeping interest rates in the 16% range. This has directly brought about the collapse of manufacturing and agriculture, and an increase by several millions in total unemployment. It has also destroyed the capability of the developing sector nations to obtain credit for their own productive economies, and purchase of American goods.

"During World War II, when recovery from the depression occurred, interest rates stayed below 1 1/2 %. We need a mobilization of our population and productive resources similar to 1939-43.

"We believe it urgently necessary to block Reagan's nomination of Volcker. We call upon all people of goodwill to run for office as a means of preventing Volcker's nomination and the policies Volcker represents."

Endorsers:

Ralph Cassimere, Chairman, Region 6, NAACP (Oklahoma, Texas, Arkansas, Louisiana and New Mexico)

Leslie Brown, Oklahoma, Chairman-Elect Region 6, NAACP

Rev. Lamar Keels, Arkansas State President, NAACP

Alex Johnson, Arizona State President, NAACP

Ed Hales, Sr., President, Washington D.C. NAACP

Barbara Simmons, Vice-President, Washington D.C. NAACP

PFred Watkins, Chairman, Dallas, Tx.4

Rev. Wade Watts, Chairman, Oklahoma State NAACP

Alfred Rucks, Chairman, New Mexico NAACP

Willie E. Ziegler, Secretary, Freeport-Roosevelt, L.I., New York NAACP

Dr. William Gibson, President, South Carolina NAACP

Dr. Evelyn Roberts, Member, NAACP Nationa Board; Ohio

Mary E. Robinson, Member, NAACP National Board; President, Iowa-Nebraska NAACP

Joe Eddie Roy, President, Colorado NAACP

Louisa Fletcher, Member, NAACP National Board; President, Kansas NAACP

Roberta Fann, Executive Committee, Cleveland, Ohio NAACP

Jesse Goodwin, First President, Detroit, Michigan

Lydia Sims, President, Washington State NAACP

Enolia McMillan, President, Maryland NAACP

Rupert Richardson, Member, National Board; President, Louisiana NAACP

O.G. Christian, President, West Philadelphia NAACP

Neal Adams, former area Chairman, Dada, Broward and Monroe Counties, Florida

Albert Sankes, Chairman, Montgomery County, Maryland NAACP

(organizational affilations for identification only)

Texas Labor Opposes Volcker

"We, as leaders of labor, want to express our outrage at the appointment of Paul Volcker to another four years as Chairman of the Federal Reserve. Paul Volcker is more responsible than any individual in the last four years for the unemployment now crippling our nation and for skyrocketing budget defeicits which threaten further cuts in vital programs affecting working people. We take this opportunity to urge Senators Tower and Bentsen in the strongest terms to vote against the confirmation of Paul Volcker in the U.S. Senate."

Endorsers:

Bob Ritchie, Business Representative, Bricklayers #6, Ft. Worth, Texas

Pete Ludwick, Business Agent, International Association of Machinists Lodge #776, Ft. Worth, Texas

Herb Kratz, Business Agent, Millwrights #1421, Arlington, Texas

(organizational affiliations for identification purposes only)

NAACP MEMBERS OPPOSE VOLCKER

Proposed Resolution to Terminate
Paul Volcker's Destructive Activities and Policies

"Paul A. Volcker has recently been renominated to be chairman of the Federal Reserve Bank for another four-year term by President Reagan. Volcker, over a three and one-half year period, has instituted a policy of keeping interest rates in the range of 16%. This has directly brought about the collapse of manufacturing and agriculture, and in increase by several millions of total unemployment. It has also destroyed the capability of the developing sector nations to obtain credit for their own productive economies, and purchase of American goods.

"During World War II, when recovery from the depression occurred, interest rates stayed below 1.5%. We need a mobilization of our population andp roductive resources similar to 1939-43.

"We believe it is urgently necessary to block Reagan's nomination of Volcker. We call upon all people of goodwill to run for office as a means of preventing Volcker's nomination and the policies Volcker represents."

Endorsers:

John Holland, Cooksville, MD.
Naomi Adams, Cleveland, OH.
Bruce Wormley, King William, VA.
Gertrude Dungee, King William, VA.
Terence Bramley, Fort Wayne, IN.
Robert Price, Silver Spring, MD.
Yolanda Williams, Wichita, KS.
Ernest Madden, Valley, CA.
Raymond Landrey, New Orleans, LA.
Aria Moore, Williamstown, N.C.
Brandon Farlander, River Ridge, LA.
Regina Winn, New Orleans, LA.
Betty Clark, Elyria, OH.
Kelly Beshearn, Saint Joseph, MO.
James Rountree, Detroit, MI.
Ronald Walker, Saint Albans, NY
Vernon Smith, MI.
Lee Donis, Lorraine, OH.
Marion Webb, Aberdeen, MD.
Eloise Edwards, Tupelo, MS.
Sandra Fields, Willowgrove, PA.
Lamarr Keels, Camben, ARK., President, NAACP of Arkansas
Mary Patton, Columbia, SC.
Louis Braxton, CA.
Jennifer Keys, Omaha, NB.
Wilmer Hogan, Omaha, NB.
Mamy Scriber, Baltimore, MD.
Bernice Burton, New Brunswick, CT.
Mrs. Tommy Walker, Lancaster, PA.
George E. Boggs, Ailes, MD.
Ester Robertson, Los Angeles, CA.

Dorothy Eure, Omaha, NB.
James Mitchell, AL.
Michael Ray Hall, Omaha, NB.
Olive Stuart, Marion, OH.
R. Henderson, Woodward, TX.
Mrs. E.E. Denkin, Kendall Park, MS.
Christine Reed, Macomb GA.
Reverand Silvester McClain, Wells, TX.
Alice Hopps, Albakurque, NM.
Jenny Montgomery, New Orleans, LA.
Betty Ekperikpe, New Orleans, LA.
T.E. Burke, New York, NY
H.C. Massey, Ogden, UT.
George Freeman, Akron, OH.
Nider Garland, Wilburforce, OH.
Robyn Battle VI, Detroit, MI.
William Travers, Waldorf, MD.
L. Michelson, New York, NY.
C. Luskin, Cheyenne, WY.
W.B. Flemming, Corpus Christi, TX.
A. Taylor, Bess, AL.
Walter Marshall, Winston Salem, NC.
Garrie Cooper, Weston, AR.
Earl Matthew, New Orleans, LA.
J.G. Arradondo, Nashville, TN.
Madeleine Rhone, Chicago, IL.
Dorothy Watson, Houston, TX.
Gale Evans, New Orleans, LA.
Pauleen White, Germantown, MD.
Willa Butler, Texas City, TX.
Laverne Bond, Memphis, TN.
Ernice Burgess, St. Louis, MO.
Carolyn Tindall, S. Orange, N.J.
Robert Beverly, Butler Glenn, VA.
Reginald Beverly, Butler Glenn, VA.
Victor Talier, Providence RI
Sarah McClamm, Marlboro, NY
Mrs. Taylor, Amity, NY

Proposed Resolution to Terminate t@eD Destructi ve Activities and Policies of
Paul A. Volcker, Federal Reserve Chairman
(Currently before NAACP National Convention in New Orleans)

"WHEREAS: Paul A. Volcker has recently been renominated to be Chairman of the Federal Reserve Bank for another four-year term by President Reagan; and

WHEREAS: Paul A. Volcker has, over a three and one-half year period, instituted a policy of keeping interest rates in the 16% range, which has directly brought about the collapse of manufacturing and agriculture, and an increase in unemployment of several millions of people; and

WHEREAS: Paul A. Volcker's policy has adversely affected the capability of the developing sector nations to obtain credit for their own productive economies, and consequently affected their capability to purchase American goods; and

WHEREAS: During World War II, when economic recovery from the Great Depression occurred, interest rates stayed at or below the level of one and one-half percent, exactly the contrary to Volcker's policy; and

WHEREAS: We need a mobilization of the population and productive resources of the United States similar to that of World War II, but that mobilization should be based on using our industry and wealth*F\I9structive rather than destructive purposes such as war; and

THEREFORE, BE IT RESOLVED, that the NAACP believes it urgently necessary to block Reagan's nomination of Paul A. Volcker to serve another term as Chairman of the Federal Reserve.

Endorsed and Passed by at NAACP National Convention by:

Region One, NAACP (California, Washington, Oregon, Alaska, Hawaii, Nevada, Arizona)

Region Six, NAACP (Louisiana, Texas, Arkansas, Oklahoma, New Mexico)

(Submitted to the Convention Resolutions Committee as an Emergency Resolution)

(organizational affilations for identification only)

Flint, Michigan NAACP Opposes Volcker

"The Executive Board of the Flint Branch of the National Association for the Advancement of Colored People being informed that the Federal Congress is being urged by Paul Adolph Volcker, Chairman of the Federal Reserve Board, to bailout the private international banks by loans of 8.5 billion dollars to the Internatonal Monetary Fund, finds as follows.

"The international debt crisis is of such a magnitude that the present proposal is a band-aid approach to a dying patient -- the present international private banking system;

"The debtor countries are essentially healthy, being wealthy in people and resources;

"The Federal Reserve Board under Volcker has pursued a relentless program of high intY>◊xwd tight money depriving U.S. industry and population of their life's blood -- credit, and has thereby put thousands of businesses into bankruptcy and has thrown millions of hard-working, productive people out of work into soup kitchens and on welfare;

"The current world depression was brought about by these views of the oligarchy dominating the International Monetary Fund, the World Bank, the private internatonal banks and the Federal Reserve Board;

"The draconian conditionalities imposed on loans by the International Monetary Fund to the debtor countries of the private international banks will worsen the depression and will cause starvation, pestilence, chaos and untold human misery in the underdeveloped debtor countries and more unemployment n the advanced industrial countries including our own.

"The owners of the international private banks are experts only in looting the working people of the world and have demonstrated their incompetence and stupidity many times in bringing the people of the world wars and economic depressions and it is time the political power of this oligarchy be broken.

WHEREFORE, BE IT RESOLVED:

1. Not one penny of U.S. taxpayer money be used to bailout private international banks.

2. The United States of America shall remonetize gold as the reserve basis of the U.S. monetary system and shall federalize the Federal Reserve System to insure its service to the prosperity of this nation and terminate its branch status of the private banking oligarchy.

3. The Unied States shall not join the oligarchy's Swiss Bank for Internatonal Settlements.

4. The United States shall initiate meetings with the debtor nations and industrial countries willing to participate to establish a new international banking system.

)i 5. The United StatesQall encourage the generation of credit necessary to expand trade and industrialization, secured by the future production as the ability to repay.

6. The United States shall adopt as policy that the world framework must be established by which the under-developed poor nations may elevate themselves to our pre-Volcker level to replace the present Volcker policy of forcing us down to the lowest level of the backward nations so he may subsidize the private banks and make good their usurious bad debts.

7. It is further resolved that a copy of this Resolution be forwarded to the National Office of the NAACP for action, the Michigan Conference of Branches, to the Michigan Congressional Delegation and to the President of the United States."

(Unanimously Adopted at a Regular Executive Meeting held May 2, 1983.)

Statement of Tom Kersey
Opposing Confirmation of Paul A. Volcker

"I feel very strongly that the confirmation of Paul Volcker's reappointment as Federal Reserve Chairman will take away any hope, however dim it might be, that agriculture will have an opportunity for any kind of recovery for the next four years.

" We feel that the Congress of the United states should look at the things that have happened in agriculture in the past four years -- at the conditions we face today and what the realistic projections for the immediate future are, and realize that with Paul Volcker's policies not only will we face a starving world, but a starving nation in the very near future."

Tom Kersey, National Chairman, Agriculture Policy Commmittee, Unadilla, Georgia

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MICHIGAN CONSTITUENCIES OPPOSE VOLCKER

"We urge you to reject the $8.4 billion bailout of the International Monetary Fund and the renomination of Paul Volcker as Chairman of the Federal Reserve Board.

"The policies of the IMF and the Federal Reserve, which bleed the real economy in the name of 'monetary stability,' have brought on the second Great Depression of the Twentieth Century.

"The U.S. should support the call of developing-sector nations for debt reorganization and creation of a new source of low-interest rate credit, which can lead to a boom in U.S. capital goods exports to these nations.

"The U.S. Constitution wisely places solely in Congress power over the supply of currency and its value. The Federal Reservodhould be reformed into an arm of economic policy subject to the control of our elected representatives. The Senate should confirm as chairman only a nominee committed to using credit and monetary policy in the service of economic growth."

Endorsers:

Max Dean, Executive Board, Genesee County Democratic Party; State Coordinator, NDPC, Flint, Michigan

Jay H. Kegerreis, Vice President, Secretary, Treasurer, Glastendert, Inc.; Member, Governmental Affairs Committee, National Assn. of Food Equipment Manufacturers, Saginaw, Michigan

Ted Albert, Former Democratic Party Chairman, Gegobic County

T. Calvin Jenerou, President, Upper Peninsula Building and Construction Trades Council, AFL-CIO, Manistique, Michigan

C.L. Lepine, Chairman, Division 831, Brotherhood of Locomotive Engineers, Dearborn, Michigan

Stanley Glass, President, IAM #82; Vice President, District Lodge #60, IAM, Detroit, Michigan

Ed Bivens, former mayor, Inkster; former chairman, National Black Republican Council]

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(organizational affilations for identification only)

STATEMENT OF BILLY DAVIS
CANDIDATE FOR GOVERNOR OF MISSISSIPPI

Gentlemen:

I am a farmer from South Mississippi and a candidate for Governor. Since the late 60's, I have seen the systematic destruction of agriculture in the United States. However, since 1979, we in the agricultural baseline productive sector have seen the monetary policy of the Federal Reserve weak havoc with our productive capabilities. We attribute this to the policies implemented by Mr. Paul A. Volcker.

In retrospect, we observe that the only sector of America which seemingly benefitted from such policies has been the speculative sector. Not directed to production of real tangible goods, very handsome paper profits have been amassed by groups not the least interested in the true wealth of America or its people, except what they can garner from their earnings. Heavy industry and agriculture have given their virtual lifeblood to maintain some semblance of progress, but are being wiped out. The position of the average American today is analogous to the citizen of pre-1776; the difference being that the destroyers of productivity are from within our country as well as without. The pinnacle of this assault is in my belief Paul A. Volcker.

The world needs American goods more today than ever before, especially south of the Tropic of Capricorn, and the trade and credit policy of the United States is locked into a third party relationship with the IMF, which is not only draining our national fiscal stability, but setting up the Treasury of the U.S. as the lender of last resort to fund a world indebtedness beyond the average citizens's imagination. Not only would this policy result in the collapse of the American dollar and world commerce, buTTQ would create hyperinflation which surely would be the epitaph of American industry and obligate generations yet unborn to taxation not of their own making. President George Washington in his Farewell Address (draft written by Alexander Hamilton), warned us of just such entanglement. Mr. Volcker would have the U.S. totally submissive to just such a profile to the benefit of a select few financial centers, foreign and domestic. I urge you to consider the potential wrath of your constitutents should Mr. Volcker be confirmed and he then openly move us even further into such entanglements, contrary to our national security. I commend to your deliberations the story of the cave in Plato's "Republic," and Amos 8:4.

Billy Davis, Candidate for Governor of Mississippi; Laurel, Mississippi
0291o

Telegram to Venezuelan President Luis Herrara Campins
Supporting Global Solution to Debt

President Luis Herrera Campins
Palacio de Miraflores
Caracas, Venezuela

Sr. President:

"We support your efforts to organize a global solution to the problem of Ibero-America's debt which can allow the economies of the Americas -- including that of the United States -- to grow again, as you stated most recently in your Independence Day address. We also endorse the call of the Caracas Congress on Latin American Political Thought for the formation of a Latin American Coordinating Council on Foreign Debt.

"In the United States, we will be organizing over 50 simultaneous conferences to support the efforts of the July 24 Bolivarian Day summit in Caracas to achieve these same goals. And we commit ourselves to use all our powers to ensure that President Reagan sends a high-level U.S. delegation to the September OAS meeting on finances and development, which is ready to deliberate on a rational, moral solution to our common economic problems."

Endorsers:

Kern, Inyo, Mono, Building Trades Council, Bakersfield, California

Doug Zimmerman, Secretary, Kern, Inyo, Mono Building Trades Council, California

Jim Wright, Business Agent, Boilermakers #732, National City, California

Tom Kersey, National Chairman, Agricultural Policy Committee, Unadilla, Georgia

~~Robert Keith, President, International Longshoremen's~~ Association #1543, Jacksonville, Florida

(organizational affilations for identification purposes only)

The CHAIRMAN. Mr. Merrill.

STATEMENT OF ROBERT E. MERRILL, VICE PRESIDENT, VIRGINIA TAXPAYERS ASSOCIATION

Mr. MERRILL. I have a prepared statement of which Lori has extra copies if you don't have an extra copy, but which I would like to highlight for a few minutes.

My name is Robert Merrill. I am vice president of the Virginia Taxpayers Association. For more than 10 years, the Virginia Taxpayers Association has been working at the State and national levels to prevent excessive Government spending and promote a sound economy. You will recall, Senator Garn, that part of the statement we gave this committee on July 30, 1979, was placed in the Congressional Record, for which we thank you. Today I come before you to ask again on behalf of the taxpayers that you not reconfirm the appointment of Paul Volcker to the chairmanship of the Federal Reserve Board. We feel sincerely that the best interests of you and the citizens of this country are better served by someone else.

I shall focus my initial remarks on the statement by President Reagan when he announced the appointment of Mr. Volcker to be chairman. President Reagan said: "Paul Volcker is a man of unquestioned independence, integrity, and ability." I will leave the comments on the integrity and ability to others. But I do want to concentrate on independence.

REASONS AGAINST VOLCKER RENOMINATION

Now, we don't know exactly what President Reagan meant when he said "independence." Independent of whom or from whom we do not know. But I submit that Mr. Volcker is not independent. Rather, he is attached to the megabanking world and is doing what is best for them, not what is best for the U.S. taxpayer. His every action is to strengthen the influence of the megabankers and the megabanks, and use tax funds to prevent the fall of these banks due to their unwise lending to poor credit risks.

Mr. Volcker has also displayed a disregard for American principles by his membership in both the Trilateral Commission and the Council on Foreign Relations. As we told this committee 4 years ago—the goals of the Council, in the words of Mr. H. Rowan Gaither, himself a CSR member, are to so change the social and economic life of the United States that it can be comfortably merged with the Soviet Union into a one-world socialist government. That is not what I want, and I don't think that's what you want.

But this is what the committee faces. This is what you face. The conventional wisdom we heard this morning says, "Don't rock the boat. Reappoint a man who would at least not cause a complete collapse." But I say to you, refuse to confirm the appointment of a man whose true goals, though unspoken, are the ultimate demise of our Republic.

So let's look at the record. Mr. Volcker came to power in 1979, when inflation as measured by the increase in the Consumer Price Index was rising at around 14 percent per year. And we'll give him partial credit for the reduction of the current rate to 4 to 5 percent; however, some credit must be given to those poor people standing in the unemployment lines looking for jobs or for unemployment checks. They have made their sacrifice.

At the same time, interest rates were allowed to rise to the high teens for construction and 15½ percent for corporate borrowing. This action put a damper on business and construction and caused a severe depression. Business failures mushroomed, and unemployment rose above 10 percent, meaning over 10 million unemployed.

Was this severe a depression necessary? Certainly, most of the blame for this severity can be placed on the policies of the Federal Reserve Board.

Now, perhaps the worst aspect of the recent monetary history under Volcker's Federal Reserve leadership is the instability and volatility of the money supply growth. This was reinforced to me this morning, listening to the questions and answers by Mr. Volcker in the other Senate building. Frankly, I got the impression when he was all done that he was going to fly this country by the seat of his pants. He didn't come out with anything definite, of course. Maybe he will next week, but I doubt it. We're going to be dragging along by the seat of our pants with whatever Mr. Volcker wants to do.

Now, in the expanding economy that we all want, a steady growth in the money supply is necesary, as nothing is so devastating to the businessman as to be whipsawed between plus and minus growth rates one after the other. Now, no matter whether you doubt the significance of M_1, M_2, and M_3, they do mean something. And the quantities and the change in those quantities does not make a good picture. Need I remind Senator Garn of the letter you got from Mr. Volcker in late 1980 bragging that at least the money growth rate in the United States was better than the growth rate in other countries.

Now, wait a minute. That was not so. As later admitted by the Federal Reserve and pointed out by Milton Friedman, the comparison reported by Mr. Volcker was not on a comparable basis, and thus was not valid. When the numbers were reworked by Milton Friedman, a different picture was shown.

The money growth rate of the United States was no better than the other countries', but the important thing is that the United States as a world leader in financial matters should have the most stability and the greatest credibility in the matter of monetary affairs.

I wish this morning I was in the position of Senator Garn, because I would love to have asked Mr. Volcker this question about this letter, and if he has written you an apology, I apologize for criticizing Mr. Volcker, but if he hasn't, I think it's high time he did write a letter to clarify this attempt to fool the American public and certainly this committee.

Also one wonders about the sharp drop in the M_1 money supply last week. Was that only coincidental? Or could it somehow be related to the impending hearings taking place today?

Also, one wonders when we remember the tremendous increase in the money supply just prior to the Presidential election in 1980.

However, as important as all these foregoing matters are, they are overshadowed by the reactions of the market. What does the market say? If we look at the price of gold, it was close to the 300 level at the beginning of Mr. Volcker's term. Recently it was above 440, and now it is down around 426. What is this telling us? I believe the gold buyers are saying that inflation is coming back, and they do not trust Mr. Volcker when he says he plans to control inflation. Likewise, if you liked the stock market at its recent high of 1250, it was, in my opinion, saying the same thing: Inflation is coming back, and interest rates are going up. That tells me, too, that inflation is going to come back.

In other words, Mr. Volcker does not have credibility in the market, because, as I said in the beginning, he is not independent.

Now, one very serious matter which I didn't intend to discuss in my remarks, although it's in my writeup, is about the International Monetary Fund. But after listening to Mr. Volcker this morning, I am convinced we need a comment on that. I greatly fear that the IMF is merely a method of transferring our savings to world debtors, World Banks—anyway, out of this country. I wish that the House would turn down the IMF.

Finally, in conclusion, I want to say again how strongly we feel that Mr. Volcker should not be reconfirmed by this committee, but instead, a man more responsive to the needs of our country and the average American citizen, someone else, should be made Chairman of the Board of the Federal Reserve.

Thank you.

[The complete statement follows:]

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VIRGINIA TAXPAYERS ASSOCIATION
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LYNCHBURG, VA. 24505

Statement by Robert E. Merrill, Vice President
before
U. S. Senate Committee on Banking, Housing and Urban Affairs
Opposing
Reconfirmation of Paul A. Volcker as Chairman of Federal Reserve Board
July 14, 1983

Mr. Chairman, my name is Robert Merrill, and I am Vice President of the Virginia Taxpayers Association. For more than 10 years the Virginia Taxpayers Association has been working at the state and national levels to stop excessive government spending and promote a sound economy, and you, Mr. Chairman, will recall placing in the Congressional Record (August 1, 1979, page S 11301) part of the statement we gave this Committee July 30, 1979 when Paul Volcker first came before the Committee for confirmation as Chairman of the Federal Reserve. At that time, we were the only organization in the country to correctly warn this Committee that if Volcker were confirmed, and here I quote from our prepared statement then, (QUOTE) "inflation can be expected to accelerate at a dangerous rate" (UNQUOTE). And that is just what happened. In the eight months between November, 1978 and July 31, 1979, the price of gold had risen a total of 112.00 Federal Reserve note "dollars" an ounce, or an average increase of 14.00 paper "dollars" a month. Yet only two months after Mr. Volcker assumed the chairmanship, the price of gold zoomed from 296.70 FRN (New York) on July 31, 1979 to 442.00 FRN on October 2, 1979, an average increase of over 72.00 Federal Reserve note "dollars" a month. Clearly inflation had accelerated dangerously under the new Volcker chairmanship, just as we predicted, with notable international lack of confidence in the American "dollar", and the Federal Reserve Board therefore changed its targeting system in October, 1979, in an attempt to better control the money supply.

I mention these facts not only for the purpose of introducing our VTA credentials but also to fill in an important "information gap" which many of Mr. Volcker's large "cheering section" in the media and elsewhere seem to be unaware of when they so frequently applaud him for "bringing down inflation." The same people in this "cheering section", we submit to you, are in just as much error today as they were four years ago, when they unanimously hailed Volcker as "the man we can really have confidence in, a savior for our troubled economy." And it is surely essential for members of this Committee, and other Americans, to recall under whose tutelage as Federal Reserve Chairman the country suffered a lot of the recent years' inflation in the first place.

As further background information for this Committee, we in the Virginia Taxpayers Association are proud also of having been the only state taxpayer organization testifying before the House Ways and Means Committee May 1, 1980 in opposition to the then-proposed withholding tax on dividends and interest, and we have a reasonable expectation of being on the prevailing side on this issue again in the present Congress. Last fall the Virginia Taxpayers Association presented a statement to the Senate Finance Committee opposing a flat-rate income tax, and we believe our side will prevail here also. In December, 1982, I presented to the House Ways and Means Committee a VTA statement on the gasoline tax increase, and back in June, 1979, we testified successfully before the Senate Judiciary Committee against cost to taxpayers of an additional national paid holiday, our testimony later being reprinted in its entirety in the Congressional Record (November 8, 1979, page E 5547). As a resident of Greenwood, Virginia, my own public service includes leadership as Foreman of a special Albemarle County Grand Jury appointed a few years ago to investigate the county government over a period of some months.

Today I come before you to ask again in behalf of taxpayers that you reject the appointment of Paul Volcker to the chairmanship of the Federal Reserve. We sincerely feel that the best interests of you and the citizens of the USA would be better served by someone else.

I shall focus my initial remarks on the statement by President Reagan when he announced the nomination of Mr. Volcker to be Chairman of the Federal Reserve Board. He said, "Paul Volcker is a man of unquestioned independence, integrity and ability." I will leave comments on integrity and ability to others and will concentrate on independence. Now, we don't know exactly what the President had in mind when he used the word "independence" --- independent of whom or from whom we do not know. But I submit that Mr. Volcker is <u>not</u> independent, rather that he is attached to the megabanking world and is doing what is best for them, not what is best for the U. S. taxpayer. His every action is to strengthen the influence of the megabanks, and to use tax funds to prevent the fall of these banks due to their unwise lending to poor credit risks.

Mr. Volcker has displayed his lack of regard for American principles by his membership in both the Trilateral Commission and the Council on Foreign Relations, as we told this Committee four years ago (in a portion of our statement that was not reprinted in the Congressional Record). Goals of the CFR, in the words of H. Rowan Gaither, himself a CFR member, are to so change the social and economic life of the United States that it can be comfortably merged with the Soviet Union into a one-world socialist government.

This, then, is what you on the Committee face. No doubt the "conventional" wisdom says "Don't rock the boat, and reappoint a man who at least has not caused a complete collapse." But I say to you: Refuse to confirm the appointment of a man whose true goals (though unspoken) are the ultimate demise of our Republic.

So let's look further at his record. Mr. Volcker came to power in 1979 when inflation as measured by the increase in the consumer price index was running at a 14 percent rate, and we will give him partial credit for a reduction to the current rate between four and five percent. (Some credit must also be given to those unemployed standing in lines who have made their sacrifice.) At the same time, interest rates were allowed to rise to the high teens for construction and to 15.5 percent for corporate borrowing. This action put a damper on business and construction and caused a severe depression. Business failures mushroomed and unemployment rose above 10 percent, meaning over 10 million people looking for work. Was this severe a depression necessary? Certainly most of the blame for the severity of this depression can be placed on the policies of the Federal Reserve. The analysis of this matter by Professor Barbara R. Bergmann of the University of Maryland, carried in the June 29 Minneapolis Star and Tribune under the headline "Volcker's Reward for Hurting the Nation", is so concise and well reasoned that we are appending Professor Bergmann's entire column to our statement as Exhibit "A".

One very important additional fact that no member of Congress should be allowed to forget: the Volcker-directed increase in interest rates also has cost Americans billions in increased taxes just to pay for extra servicing costs on the national debt, and since Mr. Volcker follows closely governmental spending and taxing decisions and is more than well aware of the continually growing U. S. deficits, he has known his interest hikes would have a lasting injurious effect on U. S. taxes and the economy ---- an effect which in more placid times could have been described as nothing less than a disaster by itself.

But perhaps the worst aspect of recent monetary history under Volcker's Federal Reserve leadership is the instability or volatility of money supply growth. In the expanding national economy that we all want, a <u>steady</u> growth in money supply is necessary, as nothing is so devastating to business activity as being whipsawed from plus to minus growth rates in rapid succession. Now, no matter whether you doubt the significance or accuracy of the M-1, M-2, M-3 figures, they do mean something, and the instability of these quantities does not make a good picture. Need I remind Senator Garn of the letter from Mr. Volcker in late 1980 bragging that at least the money growth rate in the U. S. was more stable than in foreign countries. But wait a minute; that was not so. As later admitted by the Federal Reserve and pointed out by Milton Friedman, the comparison reported by Mr. Volcker was not made on a comparable basis and thus was not valid. When the numbers were reworked by Mr. Friedman, a different picture was shown. The money growth rate variability of the U. S. was no better than other countries, but the USA as a world leader in financial matters should have the most stability thus generating the greatest creditability. A question to Mr. Volcker on this point and his answer would be a worthwhile addition to these proceedings. Also, one wonders about the sharp drop in the M-1 money supply last week. Was that only coincidental, or could it somehow be related to the impending Committee hearing taking place today? One wonders about this when we also remember the tremendous increase in money supply just prior to the presidential election in 1980!

However, important as all the foregoing matters are, they are overshadowed by the reactions of the market. What does the market say? Certainly in the days preceding the meeting of the Federal Open Market Committee this week, the attitude of people in the market itself can only be described as one of justifiable nervousness, anxiety and concern. They just don't know what is going to happen, what Mr. Volcker is really going to do. If we look at the price of gold, which admittedly has not been a "star performer" in recent months, it had been close to the 300.00 level as we said at the beginning when Volcker became Chairman August 1, 1979; recently the level above 440.00 was reached and now the price is around 426.00. What is this telling us? I believe the gold buyers are saying that inflation is coming back and they do not trust Volcker when he says he intends to control inflation. Likewise, if you liked the stock market at its recent high of about 1250, it was, in my opinion, saying the same thing: inflation is coming back. It certainly does appear that interest rates are going up, at least to some degree. In other words, Mr. Volcker does not have credibility with the markets largely because he is, as we said before, <u>not</u> independent.

One further very serious matter requiring amplification here is Volcker's role regarding the International Monetary Fund, an organization receiving considerable debate in Congress this week. The distinguished analyst M. Stanton Evans wrote earlier this year that the Federal Reserve chief (QUOTE) "has been the leading figure in promoting a further allocation of American funds to IMF, and by all accounts is also the major U. S. strategist on this issue" (UNQUOTE). Evans also pointed out that Volcker, who in his official duties as Fed Chairman is supposed to help insure that U. S. banks are following sound practices ---- that they maintain themselves on solid footing, don't engage in reckless policies, and take reasonable care of depositors' money ---- actually had been hard at work urging private bankers, and specifically smaller banks, to keep the dollars flowing to the foreign deadbeats, while the IMF bail-out was serving as the other prong of the Volcker pitchfork. In a November, 1982 speech, for example, Volcker made the astonishing statement that new loans by U. S. banks to help take care of developing countries "should not be subject to supervisory criticism.' In other words, the Fed would not apply strict standards of accountability in such cases. The evidence in short is that the central figure who is supposed to use the powers of his office to promote sound banking practices in the United States instead has been using those powers to pressure banks into <u>unsound</u> practice. Why isn't this Committee looking into this dangerous and actually scandalous "Volckergate"? As far as the Volcker-promoted extra appropriation to the IMF is concerned, with all the new money it is now looking for from several countries, the IMF will receive, as well known columnist Patrick Buchanan has said, "more than an immense slice of the accumulated savings of Western people. With it goes unprecedented clout, lethal leverage over the American banks --- to a claque of international bureaucrats who bear no allegiance whatsoever to the United States. What is taking place is not simply a transfer of savings, but a <u>transfer of sovereignty</u>."

So to conclude this VTA presentation, I want to say again how very strongly we feel that Mr. Volcker should <u>not</u> be reconfirmed by this Committee, but instead a man more responsive to the needs of the vast majority of average citizens ---- and someone who will be more willing than Volcker, as we said four years ago, to prepare for a transition to a constitutional currency that will truly safeguard the future of all Americans ---- should be made Chairman of the Board of the Federal Reserve. Thank you.

Minneapolis Star and Tribune
Wed., June 29, 1983 17A

Volcker's reward for hurting the nation

By Barbara R. Bergmann

College Park, Md.
Paul Volcker, whose stewardship at the Federal Reserve made interest rates go through the roof, made additional millions of people experience the miserable insecurity of unemployment, and caused the destruction of thousands of businesses, has been rewarded by reappointment from President Reagan.

As remarkable as the reappointment itself were the apparent pleasure with which the president's action was received on Wall Street and the calm indifference that greeted it throughout the rest of the country.

One might say Volcker has been to economic policy what Anne McGill Burford was to environmental policy. In fact, the comparison is probably unjust to Burford. Her sins seem to have been those of omission; she did not personally do any polluting. Volcker's sins, however, are of the activist variety. He maintained a ruinously constricting hold on the money supply. The lack of indignation in most quarters at his reappointment is testimony to the country's continuing confusion over economic policy, and to its short attention span.

The president's advisers know very well that the last 2½ years have been a terrible time for the United States, and that mistakes in economic policy were made that deepened and prolonged the misery, with little or no compensating benefit. Some of those mistakes were made by Volcker and some by the administration. It is reported that the White House staff originally contemplated sacking Volcker in the hope that the public could be persuaded to put all of the onus on him. Now, with an economic upturn in progress, the administration apparently has decided that the voters will not be in a blaming mood.

There is plenty of blame to go around: billions of dollars' worth of lost output, just to start with, to which must be added the extra suicides, heart attacks, ruined careers, broken marriages and child abuse that researchers have traced to the prolonged hard times. Apportioning the blame between the White House and the Federal Reserve is more difficult than toting up the casualties, but certain facts are clear.

High blame attaches to Volcker's willingness to allow interest rates, which were within his sphere of control, to reach stratospheric levels in late 1979, and then to allow them to remain there through the middle of 1982. That three-year period of excessively high interest rates strangled home, automobile and appliance sales, and depressed business investment.

Businesses and individuals were pushed to bankruptcy. High interest rates have affected the foreign-exchange markets, making it harder for our businesses to compete abroad and at home. In effect, the rates exported some jobs and killed others outright.

It is true that the stiff dose of medicine that Volcker administered to the nation has substantially reduced (at least for a time) the economy's inflationary momentum. But it has been done at a very high, and probably unnecessary, cost in human suffering and lost output. A slower and less violent approach to squeezing inflation out of the economy would have been less painful.

If Volcker deserves so much of the blame for the depth of the troubles of the last few years, how much blame is left over for the White House?

Volcker's defenders would argue that Reaganomics (which is simply a policy of huge tax cuts for richer citizens) brought on deficits that forced the chairman of the Federal Reserve to press harder on the monetary brakes than he otherwise would have had to do. There is some truth to that. But Volcker was not forced to press that hard. The major White House error was a failure to get him to ease up sooner.

The current upturn, which the president is hoping will make us all forget the last two years, is a result not of Reaganomics but of the economy's natural tendency to rebound — something that it has done seven times since 1947. However, before any rebound could take hold, Volcker had to ease up and allow interest rates to fall, which he has done.

Perhaps the person who eased up is a "new Volcker," and it was he who got reappointed. If the "old Volcker" should reappear, however, to reoccupy the chair of the Federal Reserve System, the president and the rest of us will surely rue this reappointment.

Barbara R. Bergmann is a professor of economics at the University of Maryland.

Exhibit "A"

Vol. 118, No. 133

Investors fear Fed decisions

By The Associated Press

The U.S. financial markets slumped Tuesday on another wave of investor concern that the Federal Reserve Board will act soon to push interest rates higher.

Stock and bond prices fell sharply as the the Fed's policy-making arm, the Federal Open Market Committee, opened a two-day, closed-door meeting in Washington. The panel meets regularly to set and review the nation's monetary policy.

The panel, as a matter of policy, does not immediately disclose its decisions. Some clues are expected Thursday, however, when Paul Volcker, the Fed chairman, testifies before Congress.

Many observers expect the committee to tighten the availability of reserves in the banking system, an action that may have the effect of forcing interest rates higher.

The prospect of higher interest rates has unsettled the financial markets because many people believe a surge in borrowing costs could derail the economic recovery.

The Dow Jones average of 30 industrial stocks, which had gained more than 8 points in the week's opening session, tumbled 17.02 points in moderate trading, to 1,198.52. It was the first time the Dow had dropped below 1,200 since June 10.

Prices of long-term government bonds were down about $10 for each $1,000 in value.

Analysts said the markets may have been hurt by a report from the investment firm Salomon Brothers, in which its chief economist, Henry Kaufman, predicted that interest rates were trend slightly higher over the rest of the year.

Kaufman's economic forecasts are widely watched in the investment community.

In Paris, an official of the Organization for Economic Cooperation and Development told a news conference "there is nothing to suggest nominal U.S. interest rates will go down" any time soon.

Sylvia Ostry, head of the OECD's economics and statistics department, said continued high U.S. interest rates are "a serious cause for concern," since the high cost of borrowing is likely to restrict the growth of business investment.

In its semi-annual economic forecast, the OECD said the United States is expected to continue leading the industrial Western nations out of their long recession. The agency said economic growth in the United States should average 3 percent this year, compared with a 2 percent rate for the 24 OECD members as a whole.

The OECD also said in a separate report that is expected oil prices to hold steady for the remainder of the year, despite a modest pickup in oil consumption.

In other economic developments Tuesday:

- Global Industries, a unit of Chemical Bank's economic research department, predicted that U.S. car sales will rise 16.5 percent this year from 1982, when sales hit a 21-year low. So far this year, car sales are running 13.6 percent ahead of last year.
- The House approved a bill that would give local governments $500 million a year to create public works jobs for the next three years.

Lynchburg, Va. NEWS

July 13, 1983

Page 1

Exhibit "B"

23-790 O—83——9

The CHAIRMAN. Mr. Smith.

STATEMENT OF W. C. SMITH, PITTSBURGH, PA.

Mr. SMITH. Thank you, Senator. First I would like to express my personal appreciation to you, Senator Garn, and to Senator Hecht and the other members of the Senate Banking Committee for the opportunity to appear here today and express my opinions in this matter.

My name is W. C. Smith, president of Franklin Towne Realty, Inc., engaged in the business of residential construction, real estate sales, and land development. I am a member of the National Association of Home Builders, and also a director. I am a director of the Builders Association of Metropolitan Pittsburgh, I am a realtor, and I am an attorney.

I appear before this committee as an individual to oppose the reappointment of Paul Volcker as Chairman of the Federal Reserve Board.

U.S. SAVINGS DRAINED OUT OF U.S. ECONOMY

Mr. Volcker should not be reappointed to be Chairman of the Federal Reserve Board because his nonperformance of his duties has been a major cause of the world banking crisis and the defaults in foreign loans. His nonfeasance has been the cause of high interest rates and unemployment in the United States and Europe. His lack of performance has been primarily responsible for the large number of failures of U.S. financial institutions and businesses and the increasing monopoly on banking by U.S. money center banks. The inaction and lack of supervision by Mr. Volcker has permitted and encouraged U.S. money center banks and foreign banks tapping the U.S. pool of credit to become major funding sources for the deficits of foreign governments and the expansion of foreign governments' social programs.

Since 1979, the market for U.S. savings has gone from a regional domestic dollar market to an integrated international monetary market which has drained U.S. savings out of the U.S. economy. The principal intermediaries in exporting the U.S. savings for a higher rate of return were U.S. money center banks and foreign banks registered in the United States, both of which were under the control and supervision of the Federal Reserve Board.

The potential problems arising out of this change were recognized in a Group of Thirty on risks in international bank lending, which I might add, one of the persons involved in the writing of the paper was the former Controller of the Currency, John Heineman, which stated that the growing integration of national banking systems combined with the rapid expansion of bank lending across national borders raises a wide range of issues for both banks and banking supervisors.

Among the questions raised were. Should banks be left totally free to decide the extent to which they should finance countries' deficits? Henry Wallich, a member of the Federal Reserve Board in a 1979 article in the Columbia Journal of World Business, fall 1979—which I would recommend that all the staff members of the Banking Committee and the members of this committee read— recognized that the absence of Reserve requirements on Eurodollar loans made by U.S. banks placed the domestic economy of the United States at a competitive disadvantage.

He stated that the reduction in the volume of bank credit to the U.S. economy could produce an increase in U.S. interest rates. He specifically recognized that if the U.S. money center banks or a foreign bank registered in the United States were to transfer funds into a Eurodollar deposit, it would deplete the pool of credit in the United States, thereby driving up interest rates.

What actually happened during the tenure of Mr. Volcker as Chairman of the Federal Reserve Board was that U.S. money center banks exported U.S. savings to fund the deficits and social programs of foreign governments for a higher rate of return.

Why did they get a higher rate of return? The reason is because lack of Reserve requirements, FDIC insurance, and what was not mentioned by the members of the Federal Reserve Board at the time, the fees that are gained by the banks in these transactions, which don't show in the interest rate.

Money market funds, such as Merrill Lynch, acted as the branch banks for both U.S. money center banks, European banks, and Japanese banks, making dollar-denominated loans to foreign governments in Europe, Mexico, and throughout South America.

I have in my file here a rather interesting list of the Japanese banks and foreign banks specifically, whose CD's were incorporated in specific Merrill Lynch money market funds, and also Shearson funds.

In 1981 the Federal Reserve Bulletin reported that U.S. bank loans to foreigners increased by over $90 billion. The Bank for International Settlements in the fourth quarter report of 1981 stated that the United States was by far the largest contributor of the $43 billion in new funds during the preceding quarter, with banks in the United States alone in that quarter appearing to have provided over $20 billion.

While the Congress of the United States and the President were attempting to restrict Federal expenditures and expansion of social programs and to encourage savings for investment in the U.S. economy, U.S. money center banks under the supervision of the Federal Reserve Board were exporting the same U.S. savings for a higher rate of return to support the deficits of foreign governments and encouraging and funding the expansion of foreign governments' social programs out of U.S. savings.

U.S. money market funds, through the purchase of the Eurodollar CD's and foreign banks' CD's, exported by March 1982 $43 billion of U.S. savings.

This is an unpublished report from the Treasury and the person over there who compiles this report. I can give you their name. I talked to them yesterday and it peaked at $48 billion.

Eurodollar time deposits of U.S. nonbank residents increased in the fourth quarter of 1981 to $60 billion. That's reported in the Federal Reserve Bulletin of April 1982 at page 212.

Now the interbank deposits of U.S. banks in French and German banks became a source of credit, which was not otherwise available within those economies to fund the French and German bank loans for the Russian gas pipeline.

SYNDICATED BANK LOANS BY MONEY CENTER BANKS

If you look at the loans made by Dresdener Westdeutschlandesbank and the French banks and cross reference those with the interbank deposits of U.S. money center banks, you'll find out where the funding came from for the Russian gas pipeline.

The Russian gas pipeline could have been stopped merely by stopping the transfer of U.S. savings into the interbank deposits of the German and French banks that funded the Russian gas pipeline.

The people of the United States, out of their savings, funded the Russian gas pipeline. Syndicated bank loans were made to Belgium and Sweden to support the deficits of those countries, which facilitated the dumping of steel in the United States.

I have here a tombstone on a loan to Sweden which shows the participation of all the money center banks, plus for the first time I saw in public the introduction of about 100 regional banks in the United States as participants in the loan to Sweden.

What that meant at that time, that these money center banks were now coordinating and drawing down the regional savings of the people of the United States which otherwise would have gone into automobile loans, business loans, and residential mortgages and transferring them to funding the deficit of a foreign country.

We could stop the dumping of steel from Belgium, Sweden, and several other countries if we didn't fund their deficit. It's the most direct and simple way. The only reason they're able to continue an inefficient steel industry and export steel to the United States and dump it is because we've been funding their deficits.

Syndicated bank loans were organized by money center banks which involved regional U.S. banks, which drew credit from the regional economies and transferred them to foreign economies, created higher interest rates and unemployment in the United States.

The growth of the huge syndicated loans which leads being taken by the money center banks and with the creation of regional coordinators has in effect set the interest rate for U.S. dollars, not only in the integrated international monetary market but in the domestic market as well.

When you have 100 banks sitting down and coordinating with each other a business transaction, they're setting the price of money. Now if the steel industry, the gypsum industry, the plywood industry—if any other industry in the United States had the lead companies and producers of that industry sit down at the table and set the price of a product for delivery to a customer, and then did it for every other major customer, they'd be indicted by the Justice Department.

I would submit to this committee that there is a serious line of inquiry, or should be a serious line of inquiry, on the impact of syndicated loans by money center banks relative to its impact on price setting and maintaining higher rates of interest in the United States.

The CHAIRMAN. Mr. Smith, if I could interrupt for the moment. That is a vote. We'll have to leave in about 6 minutes. We have a series of votes on defense, so I just want to warn you when you finish your testimony so you didn't get caught short.

Mr. SMITH. Thank you, sir. What did the Chairman of the Federal Reserve Board do while all those things were occurring in the domestic and international banking systems?

The answer is, nothing. At a January meeting in 1981 and in Las Vegas at the homebuilders' convention I personally questioned the Chairman and asked him was it not true that now the consumer in the United States, the homebuyer in the United States, and the Government of the United States were now competing in an international monetary market for a limited supply of U.S. savings dollars.

At that stage he acknowledged it. He said, yes. But let me comment like he commented today and a few other times, "but we get some money flowing in."

Now all of us know that the quantity of supply of credit within a pool of credit is going to affect interest rates. The only reason the money supply is coming back in the Treasury bills of the United States today is because of the default on loans in the money center banks and the persons who were holding CD's and deposits in those banks sought out a safe harbor and they transferred those funds from deposits in Citicorp, Continental Illinois, and other banks into U.S. Treasury bills.

That has helped us. But this is no reason why we should still tolerate, in the words of Mr. Wriston, "an uneven playing field."

What are the answers? Because I heard somebody ask that question this morning. The answers are quite simple; one of them is a suggestion that Henry Wallich had, reserve requirements, which in effect impose a tax on Eurodollar loans.

We want an even playing field for the consumer, the business and the Government of the United States in competition with foreign governments and foreign businesses when we're competing for U.S. savings dollars.

Right now the advantages are in favor of foreign governments and foreign businesses. I submit to you that the reason that there's a higher spread on interest rates today is the growth in syndicated loans which enable the money center banks to coordinate their efforts, plus the alternative of marketing those funds outside the United States.

The greatest thing that's happened to the economy of the United States is two things: One is the Garn-St Germain bill, which in effect started redirecting funds back into the regional economies of the United States, the regional banking system, and financial institutions.

The other was the default on foreign loans, which then had the regional banks, the S&L's and individuals, start to get out of the paper and the money center banks.

These two things together have brought a flow of funds back into the regional communities of the United States and out of the money center banks.

Now I happen to have available here—and I was just reading it today, I picked it up today—a June 22 issue of the American Banker. It points out that the hundred top banks in the United States, 38 percent of their loans went to foreign-based businesses—38 percent.

There's still a growth of foreign loans and interestingly enough, one of the banks is close to us here geographically, the largest percentage gains in foreign loans were posted by Union Trust Co. of Baltimore, First Interstate Bank of Arizona in Phoenix.

Union Trust foreign loans were up 206 percent to $181 million. First Interstate's were up 204 percent.

Apparently there are some banks which can still learn that there are some foreign customers which have creditworthiness. I know of one instance from Mellon Bank in Pittsburgh. I saw a loan to the Government of New Zealand for the New Zealand forest products industry.

There are in some parts of the world creditworthy foreign borrowers and the banks of the United States continued to transfer our savings.

The answer is either something in the nature—and I'm thinking of the Banking Committee—a regulation or a reserve requirement, a liquidity requirement or something in that category, or in the alternative, an interest equalization tax which previously existed to handle similar matters, or an export tax on the credit issued by banks, which is in support of U.S. exports.

Something along those lines has to be done.

Now the Chairman of the Federal Reserve Board was cognizant of these facts, or should have been cognizant of them. If he was not cognizant of these facts and its impact on interest rates in the U.S. economy, he shouldn't be reappointed.

I sometimes continue to wonder if he realized the significance of them after a conversation I had with him yesterday, and here he is testifying today.

The alternative is that the Federal Reserve Board understood the implication of the differential in Eurodollar deposit profits for U.S. money center banks and understood the implication of a drawdown on the pool of credit of the United States, and fostered this because it advanced his interest in reducing the pool of credit in the United States so as to reduce demand in his personal attack on inflation.

In doing that, he encouraged foreign loans to foreign countries and foreign businesses which at the present time have put the world banking system in jeopardy.

If he intellingently undersood that and permitted it to occur, I think also he should not be reappointed.

Paul Volcker is not indispensable. His principal political support is from the banking system that he has failed to adequately regulate.

Irrespective of what this committee does on the confirmation of Mr. Volcker, I suggest that this line of inquiry should be pursued, a profitable differential that exists from making Eurodollar loans and making loans in the U.S. economy. I think this is a serious matter and even if you confirm Mr. Volcker and pursue this and solve the problem, I think the best interests of this country would be well served.

[The complete statement follows.]

Before U.S. Senate Banking Committee

TESTIMONY OF W. C. SMITH BEFORE THE BANKING COMMITTEE OF THE UNITED STATES SENATE CONCERNING THE APPOINTMENT OF PAUL VOLCKER AS CHAIRMAN OF THE FEDERAL RESERVE BOARD.

My name is W. C. Smith, I am president of Franklin Towne Realty, Inc. engaged in the business of residential construction, real estate sales and land development. I am a member and director of the National Association of Home Builders, a director of the Builders Association of Metropolitan Pittsburgh, a Realtor, and an attorney.

I appear before this committee as an individual to oppose the reappointment of Paul Volcker as Chairman of the Federal Reserve Board. Mr. Volcker should not be reappointed to be Chairman of the Federal Reserve Board because his non-performance of his duties have been the major cause of the World Banking Crisis and the defaults in foreign loans. His non-feasance has been the cause of high interest rates and unemployment in the U.S. and Europe. His lack of performance has been primarily responsible for the large number of failures of U.S. financial institutions and businesses and the increasing monoply of banking in the U.S. by Money Center Banks.

The inaction and lack of supervision by Mr. Volcker has permitted and encouraged U.S. Money Center Banks and foreign banks tapping the U.S. pool of credit to become major funding sources for the deficits of foreign governments and the expansion of foreign governments social programs.

Since 1979 the market for U.S. savings has gone from a regional domestic market to an integrated international monetary market which has drained U.S. savings out of the U.S. economy. The principal intermediaries in exporting

U. S. savings for a higher rate of return were U.S. Money Center Banks and foreign banks registered in the United States. Both which were under the control and supervision of the Federal Reserve Board. The potential problems arising out of this change were recognized in a "Group of Thirty" paper on "Risks in International Bank Lending," which stated "that the growing integration of National Banking Systems combined with a rapid expansion of bank lending across National Borders raises a wide range of issues for both banks and banking supervisors...." Among the questions raised were "should banks be left totally free to decide ... the extent to which they should finance countries... deficits?"

Henry Wallich a member of the Federal Reserve Board in a 1979 article (Columbia Journal of World Business, Fall 1979) recognized that the absence of reserve requirements on Eurodollar Loans made by U.S. banks placed the domestic economy of the U.S. at a competitive disadvantage. He stated that the reduction in the volume of bank credit to the U.S. economy could produce an increase in U.S. interest rates.

What actually happened during the tenure of Mr. Volcker as chairman of the Federal Reserve Board was that U.S. Money Center Banks exported U.S. savings to fund the deficits and social programs of foreign governments for a higher rate of return. Money Market funds such as Merill Lynch acted as the branch banks for both U.S. Money Center Banks, European Banks and Japanese Banks making dollar denominated loans to foreign governments in Europe and to Mexico and throughout South America.

In 1981 the Federal Reserve Bulletin reported that U.S. Bank loans to foreigners increased by over $90 Billion Dollars. The Bank for International Settlements 4th quarter report stated that the U.S. was by far the largest contributor of the $43 billions in new funds during the last quarter, with banks in the U.S. alone appearing to have provided over $20 billion.

While the Congress of United States and the President were attempting to restrict federal expenditures and expansion of social programs and to encourage savings for investment in the U.S. economy, U.S. Money Center Banks under the supervision of the Federal Reserve Board were exporting the same U.S. savings for a higher rate of return to support the deficits of foreign governments and encouraging and funding the expansion of their social programs out of U.S. savings.

U.S. Money Market Funds through the purchase of the Eurodollar C.D.'s of U.S. and foreign banks exported by March of 1982 $43 Billion dollars of U.S. savings. (unpublished report of the Treasury) Eurodollar time deposits of U.S. non-bank residents increase in the 4th quarter of 1981 to $60 Billion dollars. (Federal Reserve Bulletin, Apr. 82 p. 212)

The interbank deposits of U.S. banks in French and German banks became a source of credit which was not otherwise available within those economies to fund French and German bank loans for the Russian gas pipe line.

Syndicated bank loans were made to Belgium and Sweden to support the deficits of those countries which facilitated the dumping of steel in the United States.

Syndicated bank loans where organized by the U.S. Money Center Banks which involved regional U.S. banks which drew credit from the regional economies of the U.S. and transferred them to foreign economies creating higher interest rates and unemployment in the U.S.

The growth of huge syndicated loans with leads being taken by the Money Center Banks and with the creation of regional "Co-ordinators" has in effect set the interest rate for U.S. dollars not only in the intergrated international monetary market but in the domestic market as well. If the plywood, gypsum, cement or steel industries coordinated and syndicated their marketing and price setting in the same fashion as Money Center Banks syndicated loans, there would be serious anti-trust and price fixing implications. I would suggest that the growth of these practices of large bank syndications of foreign loans and the establishment of the interest rate and fees for these loans is a major factor in the present unusually high spread over the cost of funds.

What did the Chairman of The Federal Reserve Board do while all these things were occuring in the domestic and international banking systems, the answer is nothing. In January 1981 in a public meeting I personally raised the question with the chairman as to whether or not U.S. consumers, businesses, and government were competing now in an international monetary market for a limited supply of U.S. savings. The Chairman at that time acknowledged that this was so.

While foreign governments were increasing their debt in dollars raised from the U.S. pool of credit creating increase risks for the world banking system and driving up interest rates in the U.S., the chairman of the Federal Reserve Board did nothing. While foreign banks including European and Japanese banks were tapping the U.S. pool of credit and savings to make loans to their own governments, and the Japanese to make loans to Mexico and throughout South America, the chairman did nothing.

Either chairman Volcker did not recognize or understand the significance of the transfer of U.S. savings from the U.S. pool of credit to fund foreign governments and foreign businesses and its implication on interest rates, unemployment, the recession and the risk of bank failures, or he did understand such implications and had other motives. If he did not understand these implications he should not be reappointed to be Chairman of the Federal Reserve Board.

The alternative is that the chairman Volcker fully understood that the pool of credit in the United States was being depleted by the transfer of U.S. dollars to foreign borrowers and that served his overall personal strategy of reducing the supply of credit in the United States so as to reduce the demand for goods and services in the U.S. Economy. If this alternative is accurate then he intentionally permitted the expansion of foreign loans which placed in jeopardy the international banking system and the international economy. In view of either alternative he should not be reappointed as Chairman.

The Federal Reserve Board and the Chairman had available to them several different tools which could have prevented these problems from occurring. Henry Wallich in in his 1979 article recognized several of these possible tools. Among his suggested solutions are reserve requirements for Eurodollar loans which could relate to the magnitude and the type of loans. <u>This would eliminate the competitive disadvantage of domestic U.S. borrowers</u>. Other tools which could be utilized are capital requirements having, a relationship to foreign loans. Another tool could be liquidity ratios similarly related to foreign loans. Additional direct limitions could be placed based on the risk factors involved. Absolutely no leadership has been asserted by Chairman Volcker in avoiding or correcting these problems.

Only after he had brought the world banking system to the edge of disaster did he act to in effect organize a bail out to be funded by tax payers of the United States.

The major factors that have started to turn this economy around have been the Garn-St. Germaine Bill which started to direct deposits back into regional financial institutions, and the impact of potential defaults of foreign borrowers which has detered further expansion of foreign lending, directing lending policies back into the U.S. domestic economy rather than high risk foreign loans.

The chairman constantly makes reference in his appearances before Congress to the U.S. government deficit, but he has totally ignored the deficits of foreign governments that are being funded out of the U.S. pool of credit. And he has taken no action which he has the power to take to diminish the utilization of the U.S. pool of credit to fund foreign governments deficits.

The U. S. pool of credit has been tapped directly and indirectly by virtually every country in the world, through U.S. Money Center Banks and foreign banks doing business in the U.S. This has been done directly by loans to France, Canada, the Canadian Provinces, Mexico, the South American Countries, New Zealand, Belgium, Denmark, Sweden, etc. and, indirectly through interbank deposits of U.S. banks in French, German, and Japanese banks. These interbank deposits are utilized to fund loans to Communist countries and including funding the Russian gas pipe line through interbank dollar deposits of U.S. banks in French and German banks.

In any other industry or business Paul Volcker would have been discharged and replaced. But in the U.S., where the banking industry has been dominated by Money Center Banks which have profited by exporting U.S. savings to support foreign governments and foreign business loans to the detriment of U.S. economy, he has been advocated for reappointment to represent the interest of these banks.

His political support comes primarily from those whom he has failed to properly supervise. The chairmanship of the Federal Reserve Board should not be given to any person with past affiliation or bias toward Money Center Banks and international banking. The appointment should go to a person whose orientation is toward the domestic economy of the United States and regional financial institutions and businesses in the U.S.

The confirmation of Paul Voelker for reappointment to the Chairmanship of the Federal Reserve Board would be a travesty. The person who has brought the world banking system and the world economy, and the banking system and the economy of the United States to the edge of disaster should not be rewarded by reappointment but rather discharged for his failures and non performance.

Respectively submitted,

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The CHAIRMAN. Gentlemen, we appreciate your willingness to testify and I certainly don't disagree with you on the nature of the problems in the economy, they're very well founded. The only place I would disagree with you is in closing and where we would have a fundamental disagreement—forget Paul Volcker as an individual, look at the Fed as an institution, all seven members. Do they have the inordinate power that you and other people think they have?

I just don't subscribe that they can cause all these things, such as—herpes, AIDS, and everything else. [Laughter.]

All three of you, in ascribing all these problems to the Fed in general, just about totally ignored this irresponsible body of which I'm a member; $200 billion deficits have something to do with these problems; $1.400 billion long-term deficit; and $125 billion of interest on the national debt has something to do with all the problems you've talked about, and Paul Volcker hasn't had anything, nor has any other Chairman, to do with the irresponsibility of this body.

Thank you very much for your willingness to testify. The hearing is adjourned.

[Whereupon, at 2:45 p.m., the hearing was adjourned.]