THE MAC NEIL - LEHRER REPORT

"PAUL VOLCKER"

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JIM LEHRER: His name is Paul Volcker. He's Chairman of the Federal Reserve Board which made some decisions over the week end that today, among other things, figured in one of the most chaotic days ever on Wall Street.

Tonight, we ask Mr. Volcker what's going on and why.

(MUSIC)

LEHRER: Good evening.

It was a day Wall Street will long remember. Eighty-two million shares of stock changed hands on the New York Stock Exchange, 16,000,000 more than on any other one day in its 188-year history. The American Exchange also set a record for shares traded. There was chaos on the floors of both all day: the New York's new electronic trading system running more than an hour behind, one market analyst describing the atmosphere as one of "restrained terror."

On the price side, the Dow Jones industrial average was down 25 points at one time. Late in the day it recovered some lost ground and finally closed more than 8 points down. But of the more than 1,600 different stocks traded, all but one hundred or so lost value. Most attributed today's tumult to Saturday's decision by the Federal Reserve to tighten money as a way to curb inflation.

The stock market's was the most dramatic, but it wasn't the only reaction. Commercial banks yesterday raised their prime rate -- what they charge their preferred customers -- to a record 14.5%. This was followed today by predictions that small business will almost immediately be unable to borrow money, and by January, people in at least 24 states won't be able to secure home mortgages.

Overseas, the price of gold went up today and the price of the dollar went down, just the opposite of what they were supposed to do.

All in all, a hectic and confusing day, the fourth in a row since the Federal Reserve made it's move. It's the four days later view of a man who started it all, Federal Reserve Chairman Paul Volcker, that we get tonight.

Robert MacNeil is off; Charlayne Hunter-Gault is in New York.

Charlayne?

CHARLAYNE HUNTER-GAULT: Even before Paul Volcker got the number one job at the Fed, he was considered the second most visible official in the Federal Reserve system. Since 1975, he'd been Chairman of the New York Fed, the operational arm of the system. Prior to that, he'd been a Wall Street banker, and has served in top Federal Treasury posts in both Republican and Democratic administrations. Mr. Volcker's broad financial experience, particularly in the area of foreign exchange, made him well-known in international financial circles. At the time of his appointment as the Chairman of the Fed, most experts predicted he would not make any radical changes in Fed policy.

Jim?

LEHRER: But I would guess, Mr. Volcker, that many of those experts are saying today that maybe they were wrong. Would you agree?

PAUL VOLCKER: Well, I don't know whether these are radical changes in Federal Reserve policy in a very fundamental sense. We want to deal with this problem of inflation, and I think that intention was perhaps reinforced in the public mind by the actions we took on Saturday. But in a very basic sense, the policy has been there, and we intend to carry it out.

LEHRER: Did you expect the stock market to react the way it has after your decision?

VOLCKER: Oh, I certainly thought there would be a reaction in the stock market. Whether you ask me whether I predict a particular volume kind of day that we had, or a particular price performance, I don't think is the point. I think the point may be that we captured their attention; we captured people's attention, and I think that's constructive in a sense, because there's been a lot of doubts, a lot of anxiety that this inflation was going to get out of control, and it's not going to get out of control if we do our job, and we're attempting to do our job, and we're going to turn the corner on this inflationary process.

LEHRER: You don't see, then, the stock market reaction as something to get worried about at this stage.

VOLCKER: No. I think people are reappraising what's been going on, and if people bought stocks with the expectation of more inflation, in a sense they may be disappointed. But if people are buying stocks in terms of the long-term future of the economy, I think without question, they ought to have more confidence in the future. I think ultimately this is good for the stock market. There's no question in my mind about that.

LEHRER: It has been four days now. Various reactions taken in a general way or taken together -- do you have any second thoughts about what you decided...

(OVERTALK)

VOLCKER: ...No, not necessarily. One can never anticipate precise reactions, but we've been dealing with the culmination of a lot of economic difficulties over a decade or more. I think we've reached a point where the anxiety about inflation had gotten very great; I think it's recognized as our number one problem; a lot of people were skeptical about whether we could deal with it. I hope they're less skeptical now than they were before, but when they were living in anticipation of inflation, and that begins to be questioned, which is fundamentally healthy, I suppose you expect some reappraisal in the securities market when that happens.

LEHRER: Was it a tough decision to make for you personally?

VOLCKER: Well, none of these decisions are easy, but I think it's -- basically it's pretty clear that the situation required some action, and I think that what I've read in reaction to the decision, people I've talked to -- I think that's a rather unanimous view that some action of this sort was what the situation called for.

LEHRER: Alright. Thank you.

Charlayne?

HUNTER-GAULT: Mr. Volcker, in the simplest of terms, what was your plan trying to accomplish?

VOLCKER: Well, you know, it's sometimes hard to be simple in a field as abstract as money, but what we're trying to accomplish in a very basic sense is to deal with this inflationary problem that's gripped us for some time. In the more immediate sense, what we want to do is make sure that the money supply is under control, because that ultimately is related to the inflationary process. And along with that, assure there isn't an excessive expansion of credit.

Now, let me make clear that it's not our intention to shut off the flow of credit, or shut off the flow of money. We would anticipate that a growing economy requires some addition to the money supply; it requires credit. But that should be kept in proportion to what the economy really needs. We don't want to finance the inflationary froth in the economy.

HUNTER-GAULT: Alright. Now you just mentioned that you plan to focus on the money supply, and that was the most dramatic part of your strategy, the most radical departure. Could you explain exactly what that means, focussing on the supply rather than on the price, which is interest rates?

VOLCKER: Well, we get into a very technical area here, but we've been concerned about the increase in the money supply as a normal part of our operation. We have changed the technique; we've changed the emphasis by which we approach the same objectives that we had before. We've put more emphasis on what you refer to as the supply side. We controlled this because the bulk of the money supply consists of bank deposits, and in a modern economy like ours, the flow of bank deposits or the total of bank deposits is ultimately controlled by how many reserves banks hold. And we can control the amount of reserves. That control is not perfect, but we're putting more emphasis on controlling the amount of reserves, which, in turn, controls the supply of money.

HUNTER-GAULT: Well, now how exactly will that impact upon inflation and help you to achieve your goal?

VOLCKER: Well, you know there -- the classic definition of inflation is too much money chasing too few goods, and ultimately, as we bring this supply of money into accord with the needs of a non-inflationary economy, you achieve a proportion between the amount of money and the amount of goods. And at that point, we can return to stable economic conditions so far as inflation is concerned. Now, we can't move there all at one step, but I think the actions on Saturday reiterated our firm intentions to do so.

Let me make one point, too, upon which I think there's been some misunderstanding. The money supply has been growing at an excessive rate, I think it's fair to say, for three or four months -- five months. I would not use the words "out of control," but it's been growing at a rate of ten percent or so. In one popular definition, that's too fast. If we looked at it in the perspective of a year, it's only been about 5%; it's actually one of the slowest rates of growth of the money supply among most countries in the world. So it hasn't -- I don't want to suggest that the difference is black and white.

HUNTER-GAULT: I see.

This kind of strategy that you've put into place on Saturday has been recommended since -- going back to 1975, but time and time again, it's been rejected. What were the reasons this approach was rejected in the past?

VOLCKER: Well, all approaches have their advantages and disadvantages. The major reason we changed now in this immediate situation was the fact that the money supply was increasing quite rapidly, and the traditional approach which put more emphasis on short-run stability and interest rates perhaps was not very useful during a particular period when the significance of the level of interest rates is much harder to judge, when the inflation rate itself is high, and when expectations about inflation may be changing. Because ultimately, the level of interest rates is related to the inflation rate, and if inflation itself is changing, or if people's fears about inflation are changing, that impacts the interest rate. It's a little harder to judge what results you're getting from interest rates alone, so instead of saying -- looking at the price of money and the interest rate, let's look at the money supply more directly as a matter of emphasis.

HUNTER-GAULT: And the same problems that might have existed in the past don't exist now?

VOLCKER: Well, no -- there's no complete certainty in this world, but we think this is a technique which, under existing circumstances, offers greater assurance that the money supply will be brought in line with our targets for this year. Those targets have not been changed; they were set first a year ago;

they were reviewed in the middle of the year --what we want to do is come within those targets. We are not far outside of those targets. We had a period of slow growth; then, more recently, a period of rapid growth -- we want to go in between.

HUNTER-GAULT: Thank you.

Jim?

LEHRER: Mr. Volcker, let's talk about what's happened so far, just in the last four days. We've already talked about the stock market; you don't see a big concern there. You think they'll come to their senses up there in New York, and everything will be fine?

VOLCKER: Well, I -- I wouldn't say that I am ever without concern about developments in financial markets, but I do think there is a reappraisal of values going on. Ultimately I think this should be positive, because the more stability we get in this economy, the more certainty there is about our own policies, I think then we have a base for judging these values better, and I think it's good for the growth of the country in the long run, and will be good for the stock market for that reason. The stock market has been depressed for years because of fears about inflation. Unless we deal with that inflationary problem...

LEHRER: ...But you wouldn't...

FOLCKER: ...the fear that's plaguing the market ought to be dissipated.

LEHRER: But you wouldn't -- then you wouldn't read what has happened the last three days on the stock market as a sign that those on Wall Street aren't real sure that your plan is going to work?

VOLCKER: Well, you know, there are a lot of skeptical people on Wall Street; there are a lot of uncertain people. I think it's inevitable when we make some change of this sort -- and perhaps some actions were taken that people didn't fully anticipate -- there is a period of uncertainty. In one sense; that's unfortunate. In another sense, let me say if they're more uncertain now about the outlook for inflation, I'm not unhappy about that. I think they ought to begin questioning some of those assumptions they made about persistence of inflation and the inevitability of inflation.

LEHRER: Alright, now, on stabilizing the dollar abroad - that was another purpose for your actions -- Monday and Tuesday that's just what happened.

VOLCKER: Right.

LEHRER: The price of the dollar went up, but today, the price went back down. Why...

(OVERTALK)

VOLCKER: ...It didn't go back down nearly as far as it went up. Let me make clear on that. We are dealing with markets that have a life of their own; a lot of people out there are trading currencies. I don't expect that market to be fixed every day. We had a very sharp and good reaction in the exchange markets; today it retreated a bit, but the dollar looks a lot better to me today internationally than it did a week ago, or before the week end, or two weeks ago, and better than it's looked for some time in terms of the basic prospects.

LEHRER: And in ther short term over the next few days and weeks, you plan to -- you expect it to remain more stable than it's been.

VOLCKER: I think the outlook for the dollar should be stronger than it was. We're going to get some day to day movement in that market, I suspect...

LEHRER: ...Up and down...

VOCKER: ...and the market will be probing for a stable trading level. As they adapt to their new expectations, you can expect some ups and downs on particular days, but in the end, I think -- well, there's just no question that this kind of measure helps the dollar.

LEHRER: Same thing with gold? Obviously, in gold you want the price to go down...

VOLCKER: ...Sure...

LEHRER: ...but now it went up.

VOLCKER: ...but gold is...

LEHRER: And it did the same thing -- it flip-flopped.

VOLCKER: It's a very special kind of highly speculative market, as you know. The gold market has, among other things, a lot of vested interests built into it; there are a lot of people in that market whose -- who'd like to see it go up; their careers are kind of tied up in that prospect, so you expect sometimes some strange reactions in that market. But again, the gold market -- I think the rise in the gold market, the reason it went up and the reason it had a fertile ground upon which to move, were these anxieties about inflation. Gold has no return in and of itself; you only buy gold if you expect the price still to go up further. Why should the price go up further unless you're fearful of inflation? Our purpose is to deal with those -- the realities of inflation, and the expectations of inflation, and we'll just have to let the gold market react to that.

LEHRER: Have you got a -- does a danger exist now of a psychological chain reaction that those people in the dollar and in the gold market might react to what happened today in Wall Street tomorrow?

VOLCKER: Well, I -- I don't take the reaction in Wall Street as any reason to change the basic appraisals about the program. There's a lot of selling in Wall Street; there was an awful lot of buying. As you pointed out, the price went down rather sharply at one point during the day, and spent most of the afternoon going up almost equally sharply. There were a lot of buyers and sellers who were sorting out their expectations, but that is part of the process. The basic point, which I really have not heard questioned, is that the kind of actions that we took do go to the heart of the inflationary problem.

LEHRER: Thus far, have you been satisfied, pleased, displeased, or whatever, in terms of what the banks have done in reaction to what you did on Saturday?

Are they playing the game the way you wanted them to play it?

VOLCKER: Well, the banks, of course, are a little confused about how to adapt to some of our particular measures. That's quite understandable; some of them are quite technical, so there have been some gyrations in the money market. Basically, nothing has happened there that's out of line with what might have been expected.

But I would make a point here. The banks have, in a sense, a heavy responsibility thrust upon them. We are looking to curtail their rate of expansion. In terms of the banking industry, slowing the growth of the money supply and slowing the growth of bank credit means you're curtailing their rate of expansion, and they should be lending at a less rapid speed than they have been, and I think their responsibility in their job, their normal working job -- they're the people in a position to do it; we rely upon them working within the market -- to sort out the demands for credit, to put emphasis on their customer needs, their continuing customer needs for financing expansion, their personal customer needs, and sort out the loans that are useful in that sense from some of the ones that may be financing more purely speculative activity, which is not very helpful, to the country or to the customers in the long run, I would suggest.

LEHRER: Thank you.

Charlayne?

HUNTER-GAULT: Mr. Volcker, let's look at some of your policies over the long run. What's your reaction to the prediction of some economists that we're heading toward a particularly nasty recession?

VOLCKER: Well, there's been a lot of talk about recessions for months, as you know. We've had a, by historical standards, a very long period of business expansion, and at this point, for a variety of reasons, retail sales have slowed down, although the latest figures look pretty good, and there's been some inventory build-up. This is the kind of circumstance which leads to concern about a recession, and I share that concern. But I also have the strong conviction that, in terms of the growth and stability of the economy over a period of time, the greatest danger is letting this inflation, or would have been letting this inflation get out of hand.

HUNTER-GAULT: So you don't agree with Secretary of the Treasury Miller who says we're half-way through a recession.

VOLCKER: That's one way of putting it; we have had some declines in business activity; in the second quarter we had a rise, and in the third quarter, the latest figures look good. I don't think that necessarily means we will not have a decline in the fourth quarter -- that's what Secretary Miller has referred to. I don't think it's necessary or pre-ordained, or changed by this program. If the recession -- if indeed it finally proves to be a recession, we'll be -- I was about to say "a serious matter." Recessions are always a serious matter, but something that we can now(?) get through in a reasonably orderly way.

HUNTER-CULAT: Do you -- how high do you think unemployment is likely to go?

VOLCKER: I haven't got any particular estimate; I -- obviously if business turns down, unemployment will rise. That has been the general prediction. I point out again that it's been the prediction for a good many months, and the last unemployment figure we had was among the best we have had.

HUNTER-GAULT: Yes, but we have...

VOLCKER: ...Employment is at an all-time high.

HUNTER-GAULT: Right, but they...

VOLCKER: ...I well understand the forecast that business may decline, and -- I'm not saying this month, next month -- but some of these inventories may be worked down; that may have some effects on production; unemployment would go up, but I haven't got any insight as to any more than a great many economists who you can talk to about just where the unemployment rate may go. It's been surprisingly strong in the sense of being surprisingly good so far.

HUNTER-GAULT: So you wouldn't put any credence in the prediction that it could reach 8% by mid-1980.

VOLCKER. Well, I'm not going to make a particular prediction on the unemployment rate.

HUNTER-GAULT: How high does it have to go before it becomes a bigger threat than the 13% inflation rate?

VOLCKER: I don't see this as an either-or proposition, and that is, I suppose, the basic point. If inflation got out of hand, it's quite clear that that would be the greatest threat to the continuing growth of the economy, to the productivity of the economy, to the investment environment, and ultimately, to employment and the ultimate threat of the greatest level of unemployment. Now, I'm not saying that unemployment will not rise. I'm saying a greater threat over a period of time would come from failing to deal with inflation rather than efforts to deal with it. Now, that can continue -- we can't forget about the need to keep growth and money restrained; we can't forget about the federal budget, even during recession periods. That does not mean that interest rates would not go down. When the money supply comes under control, when there's a sense of inflation coming under control, the most natural thing in the world would be for interest rates to come down. The sooner that happens in a real sense, the happier I would be.

HUNTER-GAULT: What do you...

VOLCKER: ...It's not going to happen if inflation goes up forever. It's not going to go up forever.

HUNTER-GAULT: What do you say to critics who charge that your strategy is going to create a credit crunch?

VOLCKER: Well, I -- this word "credit crunch" is not a word that I use. I -- credit will be available. We are not cutting off some growth, orderly growth, moderate growth in the supply of credit. There will be enough credit to finance orderly business adjustments, orderly business expansion. Our whole tactic, our whole strategy is aimed in the direction of providing growth in credit, but limiting excess.

HUNTER-GAULT: Won't that hit some customers harder than others?

VOLCKER: In the short run, as this gets sorted out, some people are going to find credit perhaps harder to buy than they did before.

HUNTER-GAULT: Any particular category of people or class of..

VOLCKER: I think that will be worked out through the market process. I wouldn't like to divide it up by categories of people; I'd rather divide it up by categories involving need. Where there is a legitimate need for credit, whether it's by a home buyer, by a consumer, or by a business man in terms of his ordinary operations, I hope he gets the credit. If he's out to finance speculation in the gold market, to take an extreme, I would think that that is not a priority use of credit at this point, or to finance speculation in commodity markets. We have some evidence of some speculation in commodity markets before the program; that kind of speculation gets financed in part by credit, too. Now, that is not a priority use of credit in the present circumstance.

HUNTER-GAULT: Thank you.

Jim?

LEHRER: Mr. Volcker, you did talk to the President or Secretary Miller before you made the decision and made the announcement on Saturday.

VOLCKER: Yes, you're right.

LEHRER What was their reaction? "Right on, Mr. Volcker"?

VOLCKER: Well, I -- nobody goes into actions like this with, I suppose, the happy spirit of "right on." I think there is a general recognition of the need for actions of this type; I think the President's comments last night, the comments of the administration earlier, the comments of Secretary Miller have indicated their fullest recognition and support of this problem.

LEHRER: There was an item in "The New York Times," I'm sure you're aware, which said that when you met with them, you threatened to resign if they didn't go along.

VOLCKER: That was absolutely nothing to that story, and the kind of indications, as I say, the President made last night indicate his own priorities in this area.

Now, let me say that monetary policy alone, while it's a very important issue, isn't the whole answer to this inflationary problem, and the kind of restraints on spending that has been going on the last couple of years is very much under-rated, I think, by some people, but it's very real. The budgetary deficit has been brought down quite sharply, and when -- you can sit here and say you'd rather not see a deficit. I'd rather not see a deficit, but let's not overlook the progress that's been made. The President, the administration have said repeatedly they don't want a premature tax cut, so I think the support is there.

LEHRER: The President also said yesterday that we've got to keep in mind that one of the major causes of inflation is fuel, over which...

VOLCKER: ...there's no control. Right.

LEHRER: ...we do not agree(?). Also food is another major cause of inflation.

VOLCKER: When you say "over which there is no control"...

LEHRER: ...I mean, monetarily.

VOLCKER: Well, to a substantial extent that is true. But let's not forget that even the increases in energy prices are not something going on out there in a completely different world. The producers are looking at inflation in the rest of the world; they're looking at inflation in the United States; they're looking at the value of the dollar; we can deal with those things, and it makes a better outlook for energy prices than we had before.

LEHRER. And a different kind of producer has just informed me we're out of time.

(LAUGHTER)

LEHRER: Thank you very much.

Good night, Charlayne.

HUNTER-GAULT: Good night, Jim.

LEHRER: We'll see you tomorrow night. I'm Jim Lehrer.

Thank you, and good night.

(MUSIC)