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An Interview with Paul A. Volcker

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Paul Volcker acted as chairman of the Federal Reserve from 1979 to 1987, and in that role participated in the Plaza Hotel meeting and press conference announcing the Accord. The previous chapter by Secretary Baker mentions how essential it was to obtain Volcker's assent to pursuing the Accord. Indeed, a picture from the press conference shows Baker grabbing Volcker to put him in front of the line-up of finance ministers, a light-hearted visual metaphor for how the Federal Reserve's cooperation would be crucial to the aims of the Accord (see photo on the next page).

In the interview, Volcker lays out his support for greater international economic coordination, both three decades ago and today. He explains, however, the concerns central bankers have with exchange rate intervention and coordinated economic policies. He emphasizes that the natural primacy policymakers place on domestic objectives—not just at central banks—disrupts most efforts at coordination. He feels we are likely left with our dollar-centric "messy system" for now.

This interview was conducted on September 28, 2015, shortly after the 30th anniversary of the Plaza Accord and three days before the Baker Institute conference, via teleconference between Houston and New York.

Russell Green: First, Mr. Volcker, let me thank you for talking to me today. It's quite an honor for me to ask some questions about the exchange rate.

Paul Volcker: I regret we have to do this at a distance, but here we are.

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The finance ministers who signed the Plaza Accord: from left, Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker, III of the United States, Nigel Lawson of the United Kingdom, and Noboru Takeshita of Japan.

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Green: Let me ask you first sort of an open-ended question: What do you think made the policy coordination efforts in the 1980s possible, and what made them successful or fall short of their potential?

Volcker: I didn't think of the efforts in the 1980s as being marked by a lot of coordination. There was no coordination in the early part of the 80s, so far as I remember, but you had change in personnel in the US Treasury Department, and the new secretary of the Treasury and his associates were much more activist in achieving coordination with some other countries. So there was a change during that period and it was all kind of symbolized by the so-called Plaza Accord.

Green: After the Plaza Accord got going, would you say that there were factors that made that effort of coordination more successful or factors that made it fall short of its potential?

Volcker: I was not an enthusiastic proponent of the Plaza Accord. I was not against it, but I was a little fearful. I thought the dollar was going to decline, and it was declining on its own. From the central bank standpoint, you're never happy about pushing your own currency down, you think it might get a little out of hand. So we had a lot of discussion as to how we were going to maintain or at least avoid a free fall. In fact, when the program was announced, you had a decline in the dollar, and there was some intervention. But there wasn't much intervention afterward, because the dollar did fall on its own, but against the background, obviously, of intent. So the Plaza Accord certainly contributed toward sizable realignment of currency value, which I do think was necessary.

Green: You mentioned the fear that the dollar might fall in an uncontrolled manner. It seems like central banks in the 1980s were more willing to include exchange rate objectives in their monetary policy decision making than they were in subsequent decades.

Volcker: I'm not sure I agree with that observation. It was a long time ago, but we had a particular problem in the United States. The priority was to deal with inflation. We conducted a restrictive policy, and it resulted, among many other things, in high interest rates and a big appreciation of the dollar. During that period, frankly, the US Treasury was not interested in doing anything to modify that, from the standpoint of intervention or otherwise, which from my standpoint was not very useful or constructive, but nonetheless that was the policy at the time. Then later, beginning in 1985, I guess, conditions changed, the Treasury attitude clearly changed, and it was much more interested in achieving some coordination internationally.

Green: So from the Federal Reserve standpoint, the exchange rate was certainly not the primary objective. Do you think it was the same for your counterparts at, say, the Bundesbank or the Bank of Japan?

Volcker: This was a long time ago, but my memory is that the Bundesbank—which ordinarily was not very pro-intervention during that period—finally in 1984, I suppose, was worried about the relative decline in the mark. They unusually wanted to intervene, and we refused to intervene at the same time to support what they were doing. Now that was an incident that didn't last very long, but it was an example of lack of cooperation internationally.

Green: Once the Plaza Accord took place, and the intervention at least superficially appeared to have been effective, there seemed to be much greater enthusiasm among finance ministries for coordination, at least in the set of meetings that led up to the Louvre Accord.

Volcker: That's true. Of course, Secretary Baker was a leader in that effort.

Green: Did that create complications for domestic monetary policy?

Volcker: I don't recall that creating particular problems in domestic monetary policy at the time the Louvre was put in place. The strictures of the Louvre Accord were violated in a few months. And I can remember from my viewpoint, you might have argued—I don't remember when it was, April or May of 1987—that the Federal Reserve could have tightened more to help maintain the stability of the dollar. We weren't as vigorous as we might have been. But it was a limited area of change or controversy at that point. You didn't get the big change until later in 1987.

Green: So would you say it's sufficient for monetary policy to be focused purely on the domestic set of objectives?

Volcker: It all depends. You can be, in circumstances in which international coordination is important to help reinforce your own objectives over time, even though at the moment it may not be exactly what you would do on domestic grounds. At other times, domestic considerations are probably going to take the foreground, and you have to do what you think is necessary that way. There aren't many central banks that aren't going to subordinate international objectives they think are contrary to their own objectives. In many cases it will be the policy of the central bank to maintain stability in the exchange rate because it's in their domestic interest. So you'll get coordination in those areas because there is no real conflict.

Green: How about other objectives like, say, international financial stability or growth outside of the domestic economy?

Volcker: Well, I happened to be, for a long time, a proponent of a somewhat more activist approach toward stability of exchange rates, and I've often written about that. I must say, it has not been very fashionable through most of the past few decades. When I see what's going on today, maybe we ought to resurrect some of that effort at closer cooperation to achieve—not perfectly fixed exchange rates by any means—but to narrow the range of fluctuation.

Green: I think I noted that in your Bretton Woods Committee speech last year you were lamenting the lack of "an official, rules-based, cooperatively managed monetary system." John Taylor has a paper at this conference [see chapter 12] in which he proposes something similar built around exchange rates, setting clear strategies, perhaps as the Fed did in 1985. Is this sort of similar to the type of reform you are looking for?

Volcker: I haven't seen his paper, so I can't tell you how similar or dissimilar it is. There was an effort two or three years ago to stimulate some interest in a report called the Palais Royal Report.[1] It was pushed particularly by the French, who historically have been on that side. I thought it had useful analysis, but it didn't have much impact.

Green: Do you have a view of what the major impediments to moving in that direction are?

Volcker: I think the major impediments are that it sounds fine in theory, but when the exchange rate objective seems to conflict with domestic urgency,

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1. Jack Boorman and André Icard, eds., *Reform of the International Monetary System: The Palais Royal Initiative* (Thousand Oaks, CA: SAGE Publications, 2011).

domestic urgency wins out. It's very difficult politically to appear to be subordinating domestic policy to international exchange rate stability, even though in the long run that may be a desirable thing to do.

Green: Let me go back to the Plaza for a second. After the Fed hiked interest rates and then Reagan came in with a very expansionary fiscal policy, it is no wonder that the dollar rose to such heights. One interpretation would be that the Plaza, with its focus on foreign exchange rates and intervention, would be seen in hindsight as sort of a "shoot the messenger" type of strategy, in the sense that the exchange rate was really just indicative of the underlying fundamentals.

Volcker: By 1985 I don't think the exchange rate was indicative of underlying fundamentals. I was convinced it was going in the other direction. But when you look at the early 1980s, I think I should point out that there was a lot of central bank cooperation, not in the exchange rate area particularly, but in dealing with the so-called Latin American debt crisis. That was a truly international effort, in conjunction with the IMF, but the United States was in a leadership position. It sought to try to avoid a breakdown of the banking system at a time when the banks were very heavily exposed to Latin American countries that couldn't pay their debts. It was an interesting incident, because US banks were certainly exposed, but even foreign central banks recognized that this was an international problem. There was just a lot of cooperation during that period.

Green: That's a good point. In discussing the Plaza-Louvre period, you've written that monetary policy can never be a solution to structural problems. When I look at that time, I think the degree of reliance on monetary stimulus in the 1980s seems small now compared to the heavy use of monetary policy today to gloss over structural issues in Europe, in Japan, in the United States, even in emerging-market countries like India. Is there a limit to how far monetary policy can provide cover for structural problems?

Volcker: I think there is a limit. Let me use the United States and China as an example. In the early part of this century, when China was running a big surplus and we were running a big deficit, everybody was kind of happy. They liked the production, they were willing to hold dollars, and we liked to import cheap stuff from China. Prices were very stable. That was a period when, in hindsight but it should have been in foresight, some basic adjustments should have been made in economic policy, apart from anything that the central bank could do to deal with that situation. Things were going smoothly, so there was no particular pressure to do anything. It was not basically, as I see it, a central banking problem. It may have been partly an exchange rate problem, but it was hard to get an agreement on the exchange rate.

Green: One of the motivations for the Plaza was that the United States had, at least at the time, what felt like a heavy reliance on foreign borrowing; with the overvalued dollar, it made us vulnerable to a disorderly drop in the dollar. We've obviously had some large imbalances since then. We've had a downgrading of America's debt rating. But we haven't had a real collapse of the dollar or a big spooking of foreign investors. Is that still a relevant fear?

Volcker: Interesting. In the land of the blind, the one-eyed man is king. The United States is doing better by and large than the rest of the world. In an uncertain, kind of turbulent situation in Europe, and now with respect to China, the dollar doesn't look so bad. I think it is dangerous over a long period of time to have the system so dependent on the dollar. Particularly the indefinite build-up of dollar holdings abroad does leave us vulnerable in different economic circumstances. Right now it doesn't hurt, but I could imagine a time when it would.

Green: Would we be better off moving to more of a multipolar system, with say the euro or the renminbi as alternatives to the dollar?

Volcker: That's a big question, and maybe so. We talk about it quite a lot, but now neither the renminbi nor the euro and the eurozone look stable enough, open enough, or strong enough, financially to carry the load. So it's left with us, and too much so.

Green: Right. It sounds like you would agree, but you know, with the volatility that we had around the time of the Plaza Accord—with the dollar going up and down by 50 percent—this year the dollar is up 20 percent....

Volcker: The big problem, of course, back at the time of the Plaza, which I'm sure Secretary Baker was worried about, was a rise of protectionist pressure in reaction to the seeming lack of competitiveness of American industry. It'll be interesting to see whether that rears its head once again here. Fortunately, I think it's been pretty quiescent.

Green: Is that part of what perhaps explains the lack of ambition to more global approaches to macroeconomics policymaking, that the fear of a negative protectionist outcome is diminished at the moment?

Volcker: I think your observation is probably correct. The sheer political pressure isn't as strong as you might have imagined it to be. But you certainly see it now in the increasing discussion about the problems of competitiveness of American industry, as recently as Caterpillar dropping 20,000 people in the paper today and yesterday and blaming it on competitive difficulties.[2]

2. On September 24, 2015, Caterpillar announced major multiyear job cut plans.

Green: Are there other factors, like an intellectual commitment to coordination or lack of leadership, that are part of the reason why we don't see more ambition in terms of coordination?

Volcker: Difficulties in terms of coordination are, I think, evident because of domestic difficulties. If you think of the three partners—the United States, Europe, and China (the United Kingdom is in a slightly different position)—the United States looks the most stable. The others are so preoccupied with their internal problems that I think it will be difficult to work something out.

Green: Where do we go from here?

Volcker: We're going to live with a rather messy system, I think. If people get aggravated enough where they've had enough problems, they go back and think about what could be done to create a more stable system. The question was raised in the middle of the crisis in 2008 and 2009. But as soon as the recovery got under way, people kind of forgot about it again, and it never went very far. That's when the so-called Palais Royal Accord was talked about. I don't see any near-term prospect of a more ordered system. I regret that, but it takes a big commitment on the part of the main actors. I don't think any of the main actors are prepared for it.

Green: If I could ask you one more question. When you speak with Janet Yellen, do you have any particular advice for her in navigating these times?

Volcker: I don't think a current chairman of the Federal Reserve Board needs advice from his or her predecessors, particularly predecessors twice removed! [Laughs.]

Green: Fair enough. Mr. Volcker, thank you very much for taking the time to speak with us.