The Legacy of Paul Volcker

Sheila Bair

Donald Kohn

John Taylor

SHEILA BAIR:

Thank you for letting me join this tribute to Paul Volcker, because he was someone who I deeply admired, and to be able to speak to his legacy is a special opportunity.

You had asked us to begin with what we viewed as his legacy. I think, for me, it's really that he was a model public servant. That emanated from his fame in breaking the back of runaway inflation, and he was famous: This tall New Yorker was famous even in my neck of the woods back in Kansas, where he wasn't very popular with the farmers. But for the traditionalists who liked to save money and not borrow, his efforts were welcomed and respected. And he got a lot of pushback for that. The politicians called for his ouster. Populists called for his head.

Taken from the transcript of the NBER Session presented at the NABE Annual Meeting, October 6, 2020. Julia Coronado moderated.

I was doing a little research on this because I remember it got quite ugly. The realtors even had a noose-shaped lapel printed up for their members that said, "Hang Tall Paul!" So, he put up with a lot, but he and his Board kept the rates high until inflation was broken. We've had a lot of price stability since then, and we can thank him for that.

That one instance was just a small part of his career. But it was so widely known, and I think it really helped serve as a role model, and led a lot of people like me, and later generations, to pursue careers in government service, particularly in financial regulation and policy.

When we saw him, we saw government service as an end to itself. It was a way to achieve tremendous public good. It's a job noble and prestigious in its own right, not just a spin through a revolving door before landing a job on Wall Street. He believed in public service both as a means to an end, and an end in itself.

There was no better evidence of Paul's complete devotion to the ideal of public service than that he spent the last years of his life in building the Volcker Alliance, where I've been proud to serve as a founding director. He understood that good policy was dependent on good management. And that good management depended on excellence in education and training of our public servants.

That is the Volcker Alliance's credo and mission, and I've been very proud to serve in pursuit of that noble cause. Because we need more Paul Volckers: We need them now more than ever. We need his brand of leadership, particularly now as we confront skyrocketing deficits and ultra-low-to-negative interest rates for as far as the eye can see.

I think we have grown too complacent with the multiyear legacy of price stability that Paul Volcker gave us. We will talk about this more later, but I did want to mention in my remarks that he was skeptical of keeping rates low to pursue this 2% inflation target. And my guess is he would not approve of the Fed's recent decision to move to inflation-averaging.

He felt the 2% target lacked empirical support and implied a false level of precision in the conduct of monetary policy. He also dismissed that it was necessary to avoid deflation. As he pointed out in his 2018 memoir, *Keeping At It*, only once in the past century have we had serious deflation: in the 1930s, though we did flirt with it during the great financial crisis.

But in both instances, the problem was the collapse of a poorly regulated financial system. As he said in the book, "The real danger comes from encouraging or inadvertently tolerating rising inflation and its close cousin of extreme speculation and risk-taking, in effect, standing by while bubbles and excesses threaten financial markets. Ironically, the easy money striving for that little inflation as means of forestalling deflation could in the end bring just exactly that about."

I'm a traditionalist here, and there will be others with different views, but I do fear that we are playing with fire, as easy money reaches unprecedented extremes, when at the same time regulators seem to be losing the will to oversee and regulate the financial system.

So this may turn out badly. I hope it doesn't; it's been undertaken with the best of intentions. But if it does turn out badly, we will need public servants with Volcker's courage and determination to make the politically unpopular moves that he undertook to bring prices under control. Let's hope that those individuals, wherever they are in power at the time, will rise to the high standard that he set for us all. Thank you.

DONALD KOHN:

It is an honor to be a part of this panel. Paul Volcker was a mentor, a role model, and a friend. It's wonderful to be able to celebrate his life. I knew him first as a staff member of the Federal Reserve Board working on the Chrysler bailout in 1979.

In his oral history that he left behind at the Fed, here's what he says: "I assigned Don Kohn to the job." Frankly, I thought Jim Kichline, my boss, assigned me. But Paul took credit for it. "I trained him," he said. "He got extracurricular training," and then, in square brackets, ["laughter"].

I'm still trying to figure out what that ["laughter"] was about, but I do know what the extracurricular training was. At least I think I know some elements there. Certainly, training in embracing a public policy goal, in this case saving Chrysler in 1979, and pursuing it relentlessly, I got to watch that firsthand.

I think another lesson that I saw there was playing the hand that you're dealt to maximum advantage. Congress dealt him a strong hand in the sense that they insisted that all the constituents of Chrysler make a sacrifice. It wasn't just the taxpayers. So Paul bargained very, very hard with the UAW, for example, but also with state governments and others that had a stake in this

I think it also taught me grounding in the real world of corporate finance, of automobiles, of financial markets: how they worked. I was a policymaking staff member with an academic background. This was my introduction to making policy in the real world. No one was better at it than Paul Volcker.

Of course, his most lasting accomplishment was conquering inflation. I was too junior a staff member to be present at the famous October 6, 1979 Federal Open Market Committee Meeting, when the committee shifted from setting an interest rate to setting a money supply target. But I was certainly deeply involved, in the aftermath, in implementing that.

Volcker was determined to reduce inflation. But no one knew how high rates would need to go to accomplish that. The incremental monetary policy process of voting on each rate decision probably wasn't going to get us to the right place. And it wasn't credible in markets, especially after Volcker narrowly won a rate increase decision in mid-September.

There was enough evidence linking money supply growth to inflation over long periods to make a shift to a quantity-based target credible and likely to succeed over time. The shift to money and reserve targets provided a rationale for very large rate increases, and that was easier to implement in the committee and easier to explain in the public.

It was the demand for money that was raising rates, not the Federal Reserve's deliberate decisions. Nonetheless, those were very tough times economically and politically. Interest rates of 20%; unemployment rates over 10% (doesn't sound so bad right now, does it, the unemployment rate thing?); rings of tractors around the Board, from Kansas, probably. Sheila?

SHEILA BAIR:

I think probably so.

DONALD KOHN:

Offices filled with two-by-fours mailed in by builders; consumer demonstrations outside the building; talk of his impeachment in Congress. But he kept at it.

I think we can draw a number of lessons, as policymakers, from his handling of the fight against inflation.

One-- and I already hinted at it-- is overcoming policy inertia.

When you get into a very difficult situation, it's often hard to take the very hard, painful steps you need to get out of it. He came up with this money supply reserve targeting thing in order to overcome the inertia that he could see within the FOMC.

A second point, that we see every day, is the importance of communicating to the public and the Congress. He was very aware-- so he had this money supply-inflation connection. That was what he was communicating. That was very much in the air, as John knows, through those years: the relationship of the money supply to inflation. So he had a solid empirical basis for doing what he was doing.

And he was very aware of the political context. I think he understood the problems he was getting into and the importance of bringing the Congress and the politics along, even though he couldn't bring every Congressperson along.

I think, most importantly, a lesson is that once an important public policy goal and a course of action to achieve it are identified, stick to it, recognizing that the short-run costs will be far outweighed by longer-term gains. The Volcker disinflation set the stage for two and a half decades of almost-uninterrupted growth. We had relatively small recessions in '90-

'91, and then again in 2000 and 2001. It was Paul's work, cemented by Alan Greenspan keeping inflation down, that made that possible.

But I think a second, maybe less obvious point here is once the calculus of short-run costs and longer-run gains flip, you can back off. And that's what happened in the fall of 1982. Inflation had receded considerably, and was still on the way down, though it was still pretty high. I looked today getting ready for this, and PCE core inflation, was like, four and a half, five percent. But it was coming down. There was high unemployment, and it was coming down.

Once that calculus changes, back off. In 1982, inflation had receded. It was still on the way down. The high interest rates of previous years were threatening debt sustainability in Latin America, and therefore the viability of several major U.S. banks.

His book, as Sheila said, is titled *Keeping At It*, and that's a great description of his lifelong pursuit of key public policy goals that sometimes, even within that overall arc of "keeping at it," the decisions on when to shift away from particular strategies require an even broader perspective, a greater subtlety of thinking and analysis, and confidence in one's own judgment and the ability to convince others of your judgment, of the decisions to undertake those strategies.

Paul Volcker had the required attributes in great abundance. He was a great Federal Reserve chairman, as Sheila said, with very sharp focus on both price stability and financial stability. The country was very, very lucky to have him where he was when he was there. Thank you.

JOHN TAYLOR:

Thank you, Julia, and it's great to be on with Don and Sheila to honor Paul Volcker. I think he changed economic history dramatically for the better. This was only partly when he was Fed chair. That was a big deal, but only partly.

In fact, I think his influence on policy went global. There's a global aspect which you can't forget. Before he was Fed chair, he did many things. He was undersecretary of the Treasury with the Nixon Administration. He advised President Obama after the Fed.

Let's not forget how colorful and distinctive he was. He was very tall. He smoked a big cigar. He graduated from Princeton summa cum laude. That's not a little thing. I think what I like to think is he combined knowledge and leadership. And he had knowledge, and he applied it, but he had the leadership to do so.

He went to the 1971 Camp David meeting where Nixon went off the gold standard and put on price controls. He was working for George Schultz, who was Treasury Secretary. George assigned him to work out a strategy of what's the new policy going to look like? He listened to people like Milton Friedman. And they actually implemented a new somewhat-flexible exchange rate strategy.

I think what Paul did, is he really got other people to think it was their idea. One of the talents of leadership, is "It's okay if it's not my idea, it's your idea." I think that's an important legacy we need to remember.

Then, of course, he went on to be Fed chair, which was even more difficult. I think the wage and price controls imposed by Nixon led to this inflationary monetary policy under Burns. Inflation and unemployment were skyrocketing. Growth was falling. It was a terrible situation.

He came in and people were excited. The markets were excited.

They knew his experience. But, unfortunately, with the first big decision, September 18th, 1979, people lost confidence. It was a very close vote to just increase the interest rate by a small amount.

He had to decide what to do. I think, to some extent, his experience at Treasury helped here because he knew how to bring to people with different views. And his decision, as Don alluded to, got unanimous support. It included an interest rate increase, 100 basis points. That was larger than the one in September. It had new reserve requirements, which some people thought was important for banks. And I think maybe most important, as Don mentioned, is he had this idea of emphasizing the money supply.

So, in a way, he could say, "Well, the interest rate decision was not really mine. It's not ours. It's what's the implication of controlling the money supply." He tried to get buy-in from people with different viewpoints. And he did. As I said, it was a unanimous decision to do it.

But I think this emphasis on the money supply is worth noting. Because that way, Volcker could say about interest rates, "It was the market: It wasn't me, it wasn't us, it was the market."

I remember a conversation I was in with him and Jim Tobin. And Jim said to Paul, "Why don't you lower interest rates, Paul?" And he looked at him and said, "I don't set interest rates. The money supply determines that." Sorry, that's the end of that story.

I think that's symbolic of his courage. And, you're right: construction workers sent him two-by-fours; farmers circled the Fed building. But Volcker stuck with it. That's part of the title of the book. One episode on *Face the Nation*, he was asked when he would stop fighting inflation. He said, "I'm not going to stop fighting inflation till it's gone. That's it."

So he stuck with it. Obviously, this was successful. Inflation fell dramatically. It set off a long period of better economic policy. Alan Greenspan, who succeeded him, continued with much of that.

I think it changed the world outlook tremendously. We had a long boom on a global scale, not just the United States. So he definitely deserves credit for slaying inflation. After he was Fed chair, he was called onto many jobs, which he did very well:

The Oil-for-Food Program at the World Bank and the United Nations. I remember seeing him at a restaurant in Washington, thinking about what to do with that.

He wrote a chapter in a book, which George Schultz and I edited. The book was called *Ending Bailouts As We Know Them*. And Paul said, I'll quote him, "While zero interest rates may be necessary at the moment, they lead to some dangerous possibilities in terms of breeding more speculative excesses."

Of course, there was the Volcker Rule to curtail proprietary trading: That made a lot of sense. And he continued to innovate.

But part of the purpose of this panel, is "What are the implications for today?"

I think he would be saying, "Let's not forget about where we're going. Let's not forget about strategy. Let's think about how fiscal policy will get on track, eventually, at least talk about that."

I think the international side is a concern he would be emphasizing. I think even in the case of fiscal policy, he would have said, "Let's think about how this is going to be undone in the future." But all throughout, the legacy, as I see it, is this incredible ability to combine knowledge. Like, for example, the cost of disinflation: Economists were saying, "This is terrible! He can't do this! We're stuck with it." "No," he said, "there's ways to do it." And he did it. And that's bringing a particular knowledge, but also the leadership to carry it out, to get a consensus, to get a view. It's a terrific legacy. Thank you.

JULIA CORONADO:

Thank you. So why don't we tackle the crisis, and sort of do the Volcker diagnosis. How do you think he would look at the episode of March and April, and the things that the Fed did? Would he approve? Or what might he have done differently, or what might he be concerned about right now?

DONALD KOHN:

I think he would have been uncomfortable, but he probably, sitting in the same seat, would have done many of the same things. I mean, he was uncomfortable with Bear Stearns. He gave a talk after that: He thought the Fed had gone to the boundaries of its authority in that thing.

I think, and here I'll draw a little bit on the experiences I had under him at the Fed, because I dealt with a number of crises with him: The Hunt Brothers silver thing, which was about to bring down Bache; the farm credit system, which was going broke because farmland prices plunged; Continental Illinois.

There were a number of these crises. Let's think about Continental Illinois: In that case he was fine with keeping the bank from collapsing and thereby bringing down a lot of smaller banks all over the Midwest; it was a big correspondent. He was very comfortable wiping out the shareholders; he was uncomfortable because the holding company debt holders didn't get wiped out.

I think his basic point was, "Save the system, punish the sinner." So the Hunt Brothers ended up putting all their assets in a trust somewhere in Delaware that the Fed had control over. The farm credit system was reformed with much stronger regulation, but the farm credit system wasn't allowed to collapse.

I think right now he would start by observing that we had a virus that no one could have anticipated. The problem came from outside the financial system. But there were elements in the financial system which looked like they were going to amplify a very difficult thing.

I'm sure he would be saying to Sheila, "We got to get the Volcker Alliance on this. We got to figure out what the problems were that led to the amplification, the extra stress, in financial markets, and correct them. I think he would be very uncomfortable with the Fed having done all this intervention, and then nothing changing on the regulation of financial markets. If the financial markets are going to have a call on Federal Reserve credit, they need to have reform at the same time.

SHEILA BAIR:
I agree with Don: I think he'd be uncomfortable with the massive intervention that's occurred. It's easy to sit here and question, though I think some public debate is good.

There's always a spectrum of options that you can choose. These are not binary choices. I think this was a problem during the financial crisis, too. Is that too often, the response is open the spigot, write the big check, got to save the system. Where maybe more targeted interventions would have been just as effective.

Paul didn't like bailouts. He understand-- he cared about-- financial stability as much as he did about price stability, and understood that bailouts could be inherently destabilizing because in many instances they can reward bad behavior.

This time there has been the massive intervention in the corporate debt market: I do think, and I've written on this, there could have been more targeted approaches, maybe more focused on the primary issuers, to help companies that really needed to access debt markets to continue to fund themselves. The whole aim of this was to help employers maintain their payrolls, to keep operations going. Whereas much more of the program’s emphasis was on the secondary market, which, of course, helped investors. And, fine, we're all happy about our 401Ks, because there's been knock-on impact with the equity market, as well. But I think he would have been more surgical about this. And also more robust in the supervisory approach, as well.

At the same time, we were loosening regulations leading up to the pandemic. And there's still been some loosening during it, including of capital regulations, while at the same time allowing banks to continue to pay dividends, Which I think is very ill-advised. I think he would have been in favor of a more robust approach on the supervisory part of this as well.

JULIA CORONADO:

Yes. So more surgical: that's interesting. He would have maybe tolerated more market volatility before acting?

SHEILA BAIR:

I think he would have done what was needed to do to help those who had not sinned. There were a lot of companies going into this who just borrowed too much money. And so too bad for them, except they employed a lot of people.

I think that's where he would have focused, as opposed to kind of a massive backstop of corporate debt markets, which has been a tremendous boon to investors. But is that really what was needed to help the real economy? I don't know how he would have come out, but I think he would have approached this in the way: "What do we really need to do?" And, yeah, I think he would have offered something a little more surgical.

The Fed's never bought corporate debt before. This has been amazing. And, boy, they went in whole hog! So I do think, 1), it was unprecedented; and, 2), it could have been a little more thoughtful and surgical.

JOHN TAYLOR:

It's hard to add to these pearls of wisdom. I think one thing that strikes me about the current situation: It's become so partisan, and people are yapping at each other. I think maybe Paul would have reduced that a little bit. He had a good sense of what to do, which tended to be apolitical, I thought.

I think he probably would have done something close to what was done in March-April. I do think he would have been thinking about a different policy going forward, at least putting it in place; remember what I said about zero interest rates.

And he was concerned about bailouts. I have another quote: "The bailout mentality has been reinforced and become pervasive after unprecedented rescues have taken place." And that's not about the current event. That's about the event that occurred in the past.

On the Volcker Alliance, I think there's a lot of state and local issues that he would have tried to weigh in on. And those are very important right now. I think the research that he would have been promoting, and Sheila's promoting now, would be beneficial.

On this average inflation target, you know, as Don said, he didn't want the number on an inflation target anyway. Even Greenspan shied away from that. So I can't believe he would be mucking around with the average and number of years and things like that. I think he would have been trying to stick with a strategy, would have taken what he was given, but emphasize, "Here's where we're going. We're not going to do this QE forever.”

His international experience and respect, I think, would have helped a lot. Because right now, of course, the ECB is going through their own review: Are they going to do what the Fed did or are they going to do something else? We don't know. They had a conference this past week, which didn't sound like they were going in that direction.

JULIA CORONADO:

Let's pivot to the policy review, which is a separate issue from the crisis management. In his time as Fed chair inflation had become embedded in expectations and in wage- and price-setting across the economy. Now, it's almost the reverse: We have inflation that's almost insensitive to the labor market.

The question is, okay, so holding rates low can generate this imprudent risk-taking. But it doesn't generate the kind of recovery that you want, either. So how do you square the circle? Is raising rates the answer to anything? How would he chime into the review? And what would he be advocating? Would he view the 2% inflation target as a bit arbitrary?

JOHN TAYLOR:

My own view is he wouldn't change that target. I think the issue of averaging inflation, and all that, he wouldn't get into. One question is, you know, Don mentioned, I mentioned, Sheila mentioned how he focused on money growth. That was part of his strategy. And I wouldn't complain if the Fed started that now; they don't talk about it at all.

Money growth is exploding, much like in the crisis. So a little bit of attention to that, I think, would be good. We don't know for sure. We never knew. In fact, even policy rules like the Taylor Rule are grounded in some money growth idea. I'd prefer if there was a little more emphasis on that. And maybe he would have tried to do that, I don't know. Actually, we don't know what he would do.

DONALD KOHN:

Right, right.

SHEILA BAIR:

Right. We could use his wisdom now.

JULIA CORONADO:

Don or Sheila, do you have views on what kind of role he might have played in this dialogue about the policy review and what's the right strategy, in a world of lower interest rates and less inflation sensitivity?

DONALD KOHN:

Well, I agree with what Sheila said in her presentation: He was not a fan of the 2%. I never talked to him about average inflation targeting. He didn't even like the 2% target: too high, too precise. He couldn't understand what was wrong with one and a half or one.

I had this discussion with him several times and never got anywhere, that you had to get inflation up to get nominal rates up so that you could lower them. He wasn't buying because he felt that the deflationary thrust, as Sheila said, came from financial instability. If the Fed and the other regulators had their eyes on financial stability, whether inflation was one and a half or two percent wouldn't matter. You wouldn't need that extra room. I think his emphasis would have been on regulatory reform.

I find it hard to believe that he would advocate raising interest rates with unemployment rates at this level and inflation as low as it has been. But he would have worried about the financial stability aspects.

The Volcker Alliance had a very thorough and thoughtful proposal for how to clean out what somebody in a panel I was on earlier today, called "The Spaghetti Bowl of Regulatory Authorities and

Regulation." I think he would have focused that way. The problem is really in the non-bank part of it. Where the authorities aren't so clear. They're split up. A lot of elements aren't really regulated or aren't regulated in the same way banks are regulated. He put special emphasis on banks in the 1980s. Banks are special; the Fed needs to have this intersection with the banks. But my impression, Sheila, from conversations I had when I was doing my Bank of England work, was that he understood that risk had migrated outside the banking sector.

SHEILA BAIR:

Absolutely.

DONALD KOHN:

The U.S. needed a robust way of dealing with what is called "macroprudential policy," looking at the whole system and taking steps. And it didn't have that.

SHEILA BAIR:

I agree with that. I think he would have been focused much more on prudential oversight, including the non-bank sector, to tame the beast-- especially a beast that can emerge from such aggressive monetary policy. I think, too, that he might have been a little more humble about the limits of monetary policy and what it can't and can achieve. Jay Powell's said this too, but, really, the fiscal side, especially at the household, small business level, the Fed is just not equipped to help.

I think corporate debt issuance has now reached $2.3 trillion. You know, that's, by far, a record for an entire year. So, great that corporations have been able to access all this cheap funding. But, really, where's the money going? What good is it doing at this point when you have so many households struggling? Monetary policy, at least with the current tools, just can't reach them.

There's only so much monetary policy can or should do. But he might have been a little bit more humble about the interventions, as I mentioned earlier. Because, what good is it doing at this point, other than creating all these speculative excesses that may come back to bite us down the road?

JULIA CORONADO:

That's a really great point. That's actually one of the questions from one of the participants here. We just heard Chair Powell today underscoring that monetary policy works best in partnership with fiscal, and, really, we need the next tranche of fiscal. "If Volcker were chair today," this is the question, "would he be asking politicians to engage in more fiscal stimulus, given the sort of fiscal issue and the rising debt and deficits?" Do you think he would be doing the same thing that Chair Powell is doing and asking for fiscal policy to take up the baton and do more?"

DONALD KOHN:

I think, in a sense, this isn't fair to either Paul or Jay. I think the problem is that Paul was very focused on the deficit. And in particular the twin deficits: the current account and budget deficits. I can remember testimony in the '80s, when I was sitting behind him, in which he pointed out what he felt was a risk of crisis because of the current account deficit, which was being pushed by the fiscal deficit. That is, the U.S. was spending more than it was producing because of fiscal policy.

And, again, I think, if I remember correctly, in 2005, '06, when people were thinking about, "Where's the next crisis coming from?" Paul was on the record as predicting a crisis, but it was a dollar crisis. This goes perhaps to John's point about his background in international diplomacy and at the Treasury Department. He was very worried about the current account deficit, which has been very high of late, and whether the demand for dollars from overseas would be there to sustain it, and then the contribution of the fiscal deficit to that. I'm not sure how much he would have been pushing for additional fiscal policy stimulus. As chair, he had the Reagan tax cuts early on. And he spent most of the next five years being worried about the twin deficits.

SHEILA BAIR:

He was not comfortable with these deficits. It would not be comparable to the current situation, I'm sure. I can only believe he would have supported that some fiscal action, given the pandemic, had to be taken. But you could be smart about the money that you spend. I can only assume he would have supported fiscal stimulus in response, and perhaps limited to areas where it's more effective--the service sector, small businesses, people losing jobs. Monetary policy cannot address those.

To John's earlier point, he would have been thinking about an exit strategy, too. So in crafting responses, I think he would have been looking at "How do we have a trajectory so we get out of this?" I do think maybe that might be a little different from the kind of mindset we're seeing now, where it just seems like this is going to be our permanent state.

JOHN TAYLOR:

I would say, first of all, this is a little hard to know, but based on his life experience and all the things he had done that Don and Sheila referred to, I think he'd be reticent to just let the budget go. I think he'd be looking at sensible things to do and looking for how we're going to get out of this eventually. They could do simulations of next year or the year after, and talk about the impacts of policies. One question I would have is, "Would he be sayin', 'Hey, is one percent inflation okay? One and a half?'" What's wrong with one and a half? I know the rationale that's given out: "No, that'll mean one, negative, terrible." But I just wonder if he would have been trying to articulate discussion about that a little bit. We don't know. My guess is he would have been, but I don't know for sure.

JULIA CORONADO:

Another question from one of the participants is around his view on the move towards increased transparency. Because when he was, engineering these bold moves, it was behind closed doors. What was his view on sort the Bernanke Fed’s, Yellen Fed's, move towards ever-more-- and also Powell--ever-more transparency? Was he skeptical of that? Did he think that that was a positive direction?

DONALD KOHN:

He was very skeptical.

He was not a fan of all this increased transparency by the central bank. I think his perspective was a political one. His concern was that the transparency meant that there would be pressure against taking moves, in his mind particularly moves to stop rising inflation by raising interest rates.

I remember Mervyn King tells a story about talking to Paul when

Mervyn was about to take over the Bank of England, and Paul advising him against extra transparency, maintaining the "mystery" of the central bank. And I had conversations with him in the 2000s, in which he couldn't really comprehend the drive for all this transparency. So I think he felt that in some sense the lack of transparency itself was protecting the Fed's independence.

SHEILA BAIR:

I would defer to John on that. I never talked with him specifically about that. I mean, he was obviously big on state and local budgeting, which is another workstream for the Volcker Alliance. Very big on transparency there. But what Don says rings absolutely true and I can see where too much transparency could inhibit decision-making at the Fed, how he would view that. But I never had a specific conversation with him about it.

JOHN TAYLOR:

The environment is now quite different. I think there's been a little move away from transparency recently, after a couple years towards it. Remember, the Fed was publishing their policy rules for six reports in a row. Then they stopped this year for reasons which are not completely clear.

I think in this environment, Paul would have been okay with stopping this—it was not really "transparency." It was more of a discussion of the particulars of where we're going. He was a strategic thinker. I think he knew what he was trying to do, and maybe the money targeting policy was sort of part of the way to get there. But I think he saw the importance of strategy, and maybe not the details of the decision-making. But who knows what he'd do now? That's the problem: We don't know.

JULIA CORONADO:

There're a few questions on the money supply. And, John, you touched on it a little bit.

You know, the way you described it, John, I think, was as a strategic move to help depoliticize what he had to do. He had to do it. This was almost a marketing device to shift attention away from the Fed's control over interest rates.

There's been a couple of questions in the chat room on this. One is: "Did he actually believe in the relationship between money supply and inflation? Or was it primarily a strategic tool, communications tool? And, you know, how do each of you feel about the money supply? And is it informative? Is it measured properly?" And, Don, maybe you can speak to why the Fed sort of did move away from it and back towards targeting interest rates?

DONALD KOHN:

I think he did believe in the long-term relationship between prices and money. There was enough empirical evidence on that. But I think it was a mixture of that and what I talked about: How are we going to get large enough interest rate increases and then decreases in order to control inflation and then get the economy going?

He was very skeptical about the step-by-step discretionary rate decisions. I can remember, in the late '80s, running into him at an event. The Fed had announced that we weren't going to pay much attention to money supply anymore. And his question was, "Well, how are you going get interest rate decisions made in a timely and accurate enough fashion?"

Even when I was on staff, we had, around the fall of '82, because of deregulation, the relationship of M1, and to a lesser extent, M2, to GDP had gone off the track. That was a rationale for dropping the money supply stuff. But how many times did I get calls down to his office: "Well, we don't have M1. We got to have something. There's got to be something there"? And I think it was as much discipline on the policymakers and a rationale for interest rate changes, but there was some also underlying belief that there was a genuine relationship.

JULIA CORONADO:

Don, do you think that there's any reason to include the money supply in policy again, or use it as one of the metrics to rely on?

DONALD KOHN:

Well, I look at it from time to time. I look, these days, much more at bank credit. I think that's a more interesting thing. I think the bank balance sheets are interesting. I think the huge growth in the money supply of late is partly businesses taking out loans in a kind of insurance way, and depositing that money at the banks.

I don't see that growth as having any implications. But I do think that one of the things that happened to economics, and monetary economics, over the '80s and '90s and 2000s, was a move away from quantity, this is what John was talking about, to solely focusing on price, interest rates, and that kind of thing. I think you need to look at both P and Q to try and figure out what the underlying demands are doing, and where the financial system is taking the economy.

JOHN TAYLOR:

I think you need to look at money growth and credit growth. It's there and it's quite a bit different now than it was in the so-called "great financial crisis" that we had. You know, the Fed has to change something to get interest rates to change, not just completely through announcements.

I don't remember Paul, before he died, saying much about a problem of one and a half percent inflation. I don't remember him saying that at all. I think he would have been on the side of, "Let's just let it move down to one and a half, what's the big deal?"

DONALD KOHN:

You're right. I mean, I had the conversation with him, and that's exactly what he would have said. Now, if he saw the one and a half sliding down towards one, and inflation expectations moving down as well, I'm not sure what he would have said. But he certainly felt like fighting like heck to get the one and a half up to two, as Sheila said, probably causing as many problems for the future in financial stability terms. He did not buy that we'd need to get it up to two in order to get inflation expectations and nominal rates up. He didn't see that.

SHEILA BAIR:

Yeah. No, he actually in his book talked about, in New Zealand, where this whole idea came from, the inflation target range being zero to two. So two is like the outer limit. So, yes, I tend to think he wouldn't have a problem with one and a half or one. I think he wanted an inflation rate that would not impact business decisions. That was basically his lodestar. And he tells a vignette about a conversation he and Greenspan had with

Janet Yellen about this. And they stated that as a principle, and Janet wanted a number. So these are just different ways to think about it and approach it. But he didn't seem to have a mechanistic approach to numbers, and asking "What's the right number?"

I am not a monetary economist. I view this more maybe from a populist perspective, but not in a bad sense. I kind of think people scratch their heads on this out in the real world: "Why is the Fed so focused on making it more expensive for me to buy things?"

I think people are getting a little tired of being manipulated, too: "So, okay, we've got inflation so it's cheap to borrow. So we’ve got to borrow, we’ve got to buy now, we’ve got to borrow from our future." I'm not sure people really want to live that way.

I actually think over time, we need to more fundamentally rethink this whole approach. And, to the extent this explosion in the money supply has not affected consumer price inflation, at least, I would suggest that's because it's not really reaching consumers!

We've got these huge hoards of cash sitting in corporate America. Another side effect of this has been increased consolidation, because it's really cheap to borrow and make acquisitions right now. And that's not necessarily good for the economy.

With technology now, with digital currency, Blockchain technology, you have very credible people who used to work with the Fed saying: "Well, maybe we should think about just printing money and giving it to people, in a reserve account, through intermediaries, for households."

So we should be asking "Where's the money going? Is the money going where we want it to?" I think that's the more fundamental question.