

Volcker: A Comparison of Service between Two Presidencies

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Abstract

Volcker: A Comparison of Service between Two Presidencies explores the actions of Paul Volcker as Chairman of the Federal Reserve from 1979-1987. Serving under presidents Jimmy Carter and Ronald Reagan, Volcker faced a host of varied political pressures as he worked to fix a troubled economy. Facing extremely high inflation, Volcker had to make politically unpopular decisions, such as raising interest rates and tightening the supply of credit. These decisions had far reaching political implications, especially for the president's facing re-election, and for the political party in power at the time. Volcker's legacy is one of integrity and character, as he remained largely unaffected by the political pressures he was exposed to, and instead did what was necessary to fix the U.S. economy.

Paul Volcker is a brilliant economist who left a legacy as the most trustworthy, stalwart, and determined Chairman of the Federal Reserve in the near century that the Fed has been in operation. During his time at the helm of the economy from 1979 to 1987 Volcker was forced to handle relations with two extremely different presidents. From 1979 to 1981 Democrat Jimmy Carter, the simple and forthright peanut farmer from Georgia, held the reins in the oval office. He was succeeded by Republican Ronald Reagan, who still held on to all the charm and oratory skill of his younger days as an actor. Both presidents had entirely different personalities, policies, and more importantly views on the economy. Put simply, while Carter believed that the American people held at least some responsibility for the state of the country, Reagan believed government was the real culprit. As documented in *Secrets of the Temple* by William Greider, soon after he was elected Reagan told the American people “In this present crisis, government is not the solution to our problem; government is the problem.”¹ Both presidents were criticized heavily for their deficits, each one reaching an unprecedented deficit during their terms. Ironically, the book *Balancing Act* by George Hager and Eric Pianin tells of how Reagan criticized Carter’s runaway deficit of 79 billion dollars during the campaign and then in the next eight years managed to consistently create the largest deficits in history². While the presidents were polar opposites in many ways they did have at least one thing in common: A deep respect, and political wariness, for Paul Volcker.

Volcker’s rise to the Head of the Federal Reserve came about from a dramatic gesture by President Carter. After the famous Malaise Speech, in which Carter blamed the American citizens for the current state of the country, the president asked his whole staff to resign and undergo evaluation. He chose not to reappoint Secretary of the Treasury Michael Blumenthal and

¹ William Greider, *Secrets of the Temple*, (New York City: Simon and Schuster, 1989): 352.

² George Hager, and Eric Pianin, *Balancing Act*, (New York City: Vintage, 1997): 96.

instead filled the vacancy with the then Fed Chairman William Miller. This created an important job opening and Volcker's name was on the short list of those qualified to fill it. Volcker had a reputation as a respectable, honest, and intelligent economist. In his position as Undersecretary of Monetary Affairs he had acted as a foreign diplomat in economic matters. In his time abroad, Volcker garnered faith and respect from many different economic and political leaders around the world. Soon after the position opened, Volcker was called in for a meeting with President Carter. Volcker thought he blew the interview completely. He had been too honest, telling the President that he believed in the independence of the Federal Reserve and that he would immediately begin to tighten the money supply if he was placed at its head. William Silber writes in his book *Volcker: The Triumph of Persistence* of how Mr. Volcker tried to ease his regret for the blunder rationally, by realizing that if he had gotten the job he would have to take an enormous pay cut. His then current salary was \$110,000 as President of the New York Federal Reserve and would drop to a measly \$57,500 if he were to take the position.³ Surprisingly for such a brilliant and esteemed economist, Volcker's personal finances were in rough shape, in large part due to his wife's illness, and taking the pay cut would mean asking his family to make a serious sacrifice. Despite this, Volcker knew in his heart if he was offered the position he would not be able to turn it down. He had a deep sense of public duty instilled in him from his father and saw the job as an opportunity to do his part for the country. The morning after the interview he was hired as the new Chairman of the Federal Reserve.

President Carter had chosen Volcker, despite the warnings from numerous advisers. They worried that putting someone so fiercely independent in control of the Fed was a bad idea, especially so close to an election year. Carter picked Volcker anyway, showing disregard for politics in favor of what he saw as the best choice for the country. Unfortunately for Carter, his

³ William L. Silber, *Volcker: The Triumph of Persistence*, (New York City: Bloomsbury Press, 2012): 147.

advisers were right. Volcker realized inflation was the biggest threat to the economy and immediately set out to get it under control. His primary mechanism for this was raising interest rates, including the discount rate and federal funds rate, to tighten the money supply. Volcker rejected strict adherence to Monetarist or Keynesian theory and used his deep understanding of the economy to solve the inflation crisis in the best way he could. Unfortunately, this way was extremely unpopular. To whip inflation Volcker had to put a stranglehold on economic growth and cause a severe recession. Volcker knew that things needed to get worse before they could get better, but that did not mean that the public, or the president, had to like it. Despite his unpopularity, Volcker managed to persevere and keep doing the dirty work that was necessary to kill inflation. He remembered Arthur Burns saying, “The Federal Reserve was willing to step hard on the monetary brakes at times — as in 1966, 1969, and 1974 — but its restrictive stance was not maintained long enough to end inflation.”⁴ Burns has the ignoble legacy of caving in to presidential pressure instead of doing what was best for the economy. Volcker would not follow suit.

Volcker had one small instance of compromise when it came to the Federal Reserve’s independence from the executive branch. He agreed to go along with President Carter’s consumer credit controls that were meant to curtail spending, despite the fact that Volcker did not actually think they would work. He felt he owed it to the President for supporting his controversial methods. Volcker rationalized this breach in policy by stating that Carter was after the same goal, just trying a different path. The two men had a decent relationship until Carter realized just how detrimental Volcker’s policy was to his election campaign. On October 2, 1980, a month before the presidential election Jimmy Carter seemed to have a change of heart

⁴ Silber, 181.

concerning Volcker's steering of the economy. He spoke out against Volcker, saying the Federal Reserve put "too much of their eggs in the money supply basket."⁵ This dramatic change in opinion came on the heels of a one-percentage point increase in the discount rate, which is the interest rate that commercial banks must pay to borrow money from the Federal Reserve. When the interest rate goes up the money supply shrinks as banks borrow less. Tightening the money supply will never be popular; however, Volcker had to do what was best for the economy and not repeat Burn's mistakes of the past. About raising the discount rate at such an inopportune time for Carter, Volcker said, "It was among the most difficult things I've done in my professional life. Jimmy Carter had appointed me, and I voted for him again in 1976, and would do so again in the upcoming election. But no matter what I thought or felt, there was no choice other than to increase the discount rate. I had a job to do."⁵ As Carter's advisers had warned, the independent and determined Volcker had inadvertently helped Reagan crush Carter in the election of 1980. Reagan would thank Volcker by making his job even harder than it already was.

Volcker knew there would be an imminent clash in policy, and in the months after Reagan's election the Chairman gave a series of dour speeches warning that there were no "quick and painless solutions."⁶ Ronald Reagan rode into the oval office on three promises: cutting taxes, increasing defense spending, and balancing the budget. He failed miserably on the third goal, largely because of his success with the first two. Tax cuts were the key tenant of supply side economics, the theory that tax cuts would stimulate the economy enough to make up for the money lost in tax revenue and then some. It was a politician's dream, but unfortunately it did not translate into reality. The extreme tax cuts and unprecedented defense spending led to soaring deficits. Despite Reagan's pledge that he would continue the fight against inflation, the

⁵ Ibid., 191.

⁶ Grieder, 355.

president was much more worried about high interest rates hindering economic growth. Unfortunately, immediate economic growth directly opposed Volcker's remedy for inflation. Volcker had promised that once inflation starting falling interest rates would follow. Long-term interest rates did not follow Volcker's prediction and inexplicably rose, despite lowered inflation. The Reagan administration took the opportunity to attack Volcker and blame the Fed's policies for this increase. Upon further analysis, it became probable that Reagan only had himself to blame. Tax cuts would leave a gap in the budget that had to be filled from some new revenue source, which ideally would have been spending cuts. Talking about spending cuts is a lot easier than implementing them, and the new revenue source turned out to be excessive borrowing. The rapid increase in borrowing conceivably led to the higher long-term interest rates. The administration denied this correlation and continued to use Volcker as a scapegoat. Senator Lawton Chiles summarizes it well: "...it is going to be a lot easier to cut the head off the Federal Reserve System than to make these huge [spending] cuts."⁷ The President and Mr. Volcker somehow managed to each continue on with their very different methods for the next few years. Volcker refused to monetize the deficit by loosening controls on the money supply, thus forcing Reagan to minimize the American impact of the deficit by financing it in Europe and Asia. Given their drastically different views, no one was holding their breath for Volcker to be reappointed in 1983. Volcker himself warned the president before he had made a decision that he would only stay for 18 months to two years before resigning if he was reappointed. Volcker knew he owed at least that much to his wife, as his prolonged pay-cut had proven to be a great burden for her and their family. Reagan, however, had no real choice in the matter, as no one could compete with Volcker's standing and respect. Volcker was quickly reappointed and ready to finish what he started.

⁷ Silber, 207.

In 1985, on Volcker's sixth anniversary as Chairman of the Fed, inflation had declined to 3.4% from the 12% it was at when he first took office. The economy had managed to rebound from the recession and inflation was at its lowest level in five years.⁸ It would have been the perfect time to resign if it was not for one final blemish: the high long-term interest rates caused by the even higher deficit. Nevertheless, help was soon on the way, in part because of Volcker's refusal to monetize the deficit. By not taking the easy, irresponsible way out Volcker forced a state of crisis that was perfect to give the Gramm-Rudman-Hollings bill the support it needed to pass on December 11, 1985.⁹ The bill promised automatic spending cuts if the deficit was not eliminated by 1991. The bill, which eventually fell apart, still managed to garner enough confidence to finally lower the long term interest rates. All was well and Volcker's resignation was just a matter of time. The catalyst was insurrection at the Federal Reserve Board. The presidentially appointed members have staggered two-year terms, to minimize presidential influence, but the two-term Reagan was around long enough to appoint 4 of the 7 members. This led to a board consisting of a majority against Volcker, showing that the Fed's political independence was not infallible. Partisan politics prevailed and relations on the Board quickly deteriorated. On June 2, 1987 Volcker finally had the pleasure of resigning from the position he held so successfully. Despite their opposing ideologies, Reagan knew Volcker was the best man for the job and accepted his resignation with "great reluctance and regret."¹⁰ Chuck Schumer stated bluntly that Reagan "should have been on his hands and knees begging Mr. Volcker to stay."¹⁰ Schumer was proven right the very next day, as the U.S. dollar plummeted in response to uncertainty in the financial system after the loss of the paragon of integrity that is Paul Volcker.

⁸ Ibid., 247.

⁹ Ibid., 249.

¹⁰ Ibid., 262.

Volcker's wild ride through two presidencies shows that, despite the its independent status, politics can never be completely extricated from the workings of the Federal Reserve. Volcker was a model of determination as he doggedly beat down inflation while dodging political hurdles along the way. Jimmy Carter mainly dealt with Volcker by not dealing with him, letting the Fed do what was necessary and only breaking down and criticizing when it was clear that Volcker's actions would give Reagan the election. Reagan, despite his completely contradictory economic policy, did respect the threat of inflation enough to allow Volcker to get a firm grip on the issue without too much direct interference. He never made it easy for Volcker, but the results speak for themselves. Both presidents appointed Volcker despite the danger of his independence and controversial methods. This makes it clear that despite their drastically different economic and political beliefs, deep down, the interests of the country were the presidents' prime concern, and they both knew Volcker was the right man to have in charge.

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2. Scientists have made a comparison between molecules and atoms in the past. 3. Scientists have compared molecules with atoms in the past. 4. Scientists have compared molecules to atoms in the past. when to use "comparison of" , "comparison between" & "comparison to". Apr 09 2009 23:48:59. akc. +0. To my ear, the verb version and the noun version are interchangeable. "To compare" is "to make a comparison." I compared A to B. I compared A and B. I compared A with B. I made a comparison of A and B. I made a comparison between A and B. I made