Cumberland Advisors Market Commentary – Bob Eisenbeis shares Personal Reflections of Paul Volcker

Reading a number of the tributes to Paul Volcker, who passed away last week, and recitations of his contributions brought back my own experiences with him when I was on the staff of the Federal Reserve Board from 1976–1981. Among his key attributes were his integrity, the quality of his public service, his concern for the independence of the Fed, and his commitment to break the back of inflation despite the personal and political attacks he incurred in response to his policies designed to achieve that end.

By way of background, prior to Volcker's ascending from being president of the Federal Reserve Bank of New York to becoming Board and FOMC chairman in August 1979, the FOMC had been raising rates fairly steadily by 25 to 50 basis points from the fall of 1977 through August, at which point inflation was running at an annual rate of about 8%. One month later, after Volcker assumed chairmanship, the fed funds rate was at 11.5% for September, and inflation was at 11.9%. By late October 1979, the funds rate was at 15.5%, before it declined to 14% in late November. A recession started in January 1980, and the funds rate peaked at 20% in March. What we forget is that at that time the FOMC was not pursuing a funds rate target per se, but rather had in 1978 and through the period focused on specifying growth rates for the monetary aggregates through bank reserve control while articulating target ranges for the funds rate, given growth in the aggregates. Today, of course, there is no mention in either the minutes or transcripts of monetary aggregates.

Much of this commentary is spoken by Bob on camera about his thoughts and relationship with Paul Volcker.

Volcker was not unmindful that his policies of trying to slow the growth of the money supply would have implications for interest rates, but in addition he was concerned about the effects of interest rates on bank safety and soundness, since the banks tended to fund longer-term assets with short-term liabilities whose costs could increase to the point that earnings might go negative and eat up banks' capital cushion. I was not involved at all in monetary policy during the time Volcker was chairman, but I was the senior officer in the research division responsible for bank and bank holding company research and policy, as well as research support on bank supervisory issues, consumer affairs concerns, and payments system issues. Because of these duties, in late 1979 I was summoned to Volcker's office together with another colleague and told that we were to attempt to determine how much pressure money center banks could stand on their capital positions should interest rates move higher. Moreover, we were instructed not to tell anyone that we were working on that issue, not even the other governors. Needless to say, this task put both of us in a very uncomfortable position, since the culture of the Fed was that we worked for the Board and not individual governors or the chairman. This experience showed the depth of Volcker's concerns about the possible unintended consequences of his attempt to break the back of inflation.

Volcker's policies were extremely unpopular both politically with the White House and with the general public. The Board was bombarded with shipments of 18-inch two by fours from the houses that weren't being built and received many nail kegs filled with keys from cars and houses that had not been sold.

Constitution Avenue in front of the Board building was the scene of parades of farmers on tractors protesting the policies. In fact, Volcker was reluctant to go out to dinner because people would recognize him and harangue him about his policies. In the end, however, he was successful; and the negatives expressed at the time have long disappeared as his contribution has been recognized.

Volcker had economic views that extended far beyond monetary policy. For example, he was quite conservative when it came bank holding company policies. He was, for example, against permitting bank holding companies from acquiring thrift institutions. Remember that the thrift crisis of the 1980s was a creature of the combination of binding Reg Q ceilings and the run-up in interest rates that caused many thrifts to fail. Volker's view was that keeping certain institutions balkanized in market segments would provide a safety net should one part of an industry experience financial difficulties. The problems would not infect other financial market sectors, causing a broad financial crisis. This view was what was behind the so-called "Volcker Rule" that was included in the Dodd-Frank legislation, designed to limit banks' ability to engage in proprietary trading of securities, derivatives, options, and commodity futures. It also barred banks or insured institutions from acquiring ownership in hedge funds and private equity funds. The aim was to prevent excessive risk taking by federally insured banking institutions and to limit speculative trading that might pose undue risks to bank customers. To Volcker, segmentation meant protection and financial stability.

Finally, when we remember Volcker's tenure at the Fed, it is also important to note that he tended to be relatively secluded when it came to policy. He relied mainly on just a handful of advisors, which included Jerry Corrigan. Corrigan had been a senior officer at the New York Fed, and Volcker had brought him along at the beginning of his tenure. Corrigan subsequently became president of the Federal Reserve Bank of Minneapolis before moving to the presidency of the New York Fed. Another confidant was the general counsel Mike Bradfield, whom Volcker hired. Bradfield was not attuned to the Fed culture and was a pit bull when it came to pursuing issues and asserting power. Bradfield surfaced in the aftermath of the financial crisis as a proponent of the Volcker Rule and also played a role as the driving force that uncovered dormant Swiss bank accounts that had been owned by victims of Nazi persecutions. Bradfield was known as Volcker's enforcer, and he never fully adjusted while at the Fed to being a lawyer in an institution controlled by economists. To that point, on his first trip to the Fed of Kansas City's Jackson Hole conference, Bradfield went on a whitewater rafting trip the first day, during which he fell off the raft and lost his glasses. I had several staff claim to me during the conference that they were the ones who pushed him. Volcker's final key confidant was Steve Axelrod, who was Staff Director for Monetary Policy, a position in the office of the Board members that does not exist now. Steve was in charge of coordinating monetary policy for the Board. He was not a division director but because of his position he could order any of the research staff to do his bidding.

Despite Volcker's tendency to listen to only a few close associates when it came to key policy issues, but unlike Arthur Burns, he was respectful and tolerant of staff. I was fortunate enough to have a chance five years or so ago to sit down with Paul at a Federal Reserve Bank of Chicago conference and discuss the past. Despite my previous position as one of just many Fed staffers, he was cordial and more than willing to talk about old times and experiences. The qualities noted at the beginning of this piece were still as strong as ever. That conversation was a real treat that I will always remember.

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