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Original Article

Some Facts about Paul Volcker as Chairman of the Federal Reserve (August 6, 1979 – August 11, 1987)

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Abstract: *The Federal Reserve system in the United States plays a key role in the economy. It is supervised by the seven-member Board of Governors of the Federal Reserve. The key person on the board is the Chairman of the Federal Reserve. A very notable chairman was Paul Volcker. He was Chairman of the Federal Reserve from August 6, 1979, through August 11, 1987. His chairmanship is especially important in examining the disinflation of the 1980s. In order to quell the high inflation, Volcker had to pursue a more restrictive monetary policy than was pursued in the few years before he became Federal Reserve chairman. Volcker earned a Bachelors degree from Princeton and a Masters from Harvard. Additionally, he studied at the London School of Economics. He worked in various capacities at Chase Manhattan Bank, the U.S. Treasury and the New York Federal Reserve Bank before becoming Chairman of the Federal Reserve. After his terms as Federal Reserve chair, he worked in investment banking and international economic and monetary affairs and had recommendations regarding international accounting standards. He also was chair of an Independent Committee to examine the unfinished stories of the Holocaust's Jewish victims. He was picked to investigate potential wrongdoing in the Iraqi Oil for Food initiative. He belonged to numerous international organizations and received a multitude of honors and honorary degrees. He is credited with helping the prestige of the Federal Reserve Banking system.*

The Federal Reserve Banking system has at its head a seven-member Board of Governors at its head. The seven members of that board are appointed by Presidents and confirmed by the Senate (Mishkin, 2018). The board sets monetary policy. It is implemented through the twelve Federal Reserve banks scattered across the country. They are in Atlanta, Boston; Chicago; Cleveland; Dallas; Kansas City, Missouri; Minneapolis; New York; Philadelphia; Richmond, Virginia; St. Louis, Missouri; San Francisco. In addition, there are sub-branches as well (Mishkin, 2018). One of the posts that Paul Volcker held before becoming Chairman of the Federal Reserve was that of president of the New York Federal Reserve, whose branch has special significance. The Fed Open Market Operations are implemented at that branch. Also, New York is home to some of the very largest banks. So Volcker, having been president of the New York branch of the Federal Reserve, helped prepare Volcker for the ultimate role of Chairman of the Federal Reserve (Mishkin, 2018). The next section of this paper will review the education and career of Volcker prior to his appointment as chair of the Federal Reserve. Then, his work as Chairman will be summarized. After that, some graphs of certain variables will be displayed. He also had an eventful post-career after the Fed. This will be explored, as well. Finally, there will be a summary conclusion of this article.

Keywords: *Paul Volcker, Recession 1980-82, Stagflation, Inflation, Monetary Policy, Federal Reserve Board of Governors.*
JEL Codes: *E00, E40, E50, E60, N22*

I. PAUL VOLCKER (SEPTEMBER 5, 1927 – DECEMBER 8, 2019): LIFE BEFORE BEING CHAIRMAN OF THE FEDERAL RESERVE

The career of Paul Volcker starts with his education. His Bachelor's. was earned at Princeton, where he graduated in 1949. His senior thesis foreshadowed his future interest. The thesis was entitled "The Problems of Federal Reserve Policy since WWII." In the thesis, Volcker concluded that combined wartime policies of the Department of the Treasury and the Federal Reserve had produced high levels of inflation, and the Federal Reserve needed to take steps to slow growth in the money supply (Volcker, 1949; Treaster, 2004; Shen, 2020). This was followed by Volcker earning a Masters. In political economy in 1951 at Harvard University. He had additional education at the London School of Economics (Shen, 2020). His first major position was as a full-time economist at the Federal Reserve Bank of New York, where he started work in 1952. At that time, he worked for a time as a junior research economist at the Federal Reserve Bank of New York. In 1957, he left that post and joined the staff of Chase Manhattan Bank. In 1962, he returned to government service as director of the U.S. Treasury's Office of Financial Analysis (Treaster, 2004; Shen, 2020). In 1963, Volcker became the Officer of Financial Analysis under the Deputy Undersecretary for monetary affairs in the U.S. Treasury Department (Shen, 2020).

Then, in 1965, he left public service to join the Chase Manhattan Bank again, this time as a vice-president. Yet in 1967, he returned to the U.S. Treasury in the role of Deputy Under Secretary for Monetary Affairs and, in 1969, became Under Secretary himself. Throughout his five years in the position, Volcker brought about many changes to the international monetary system (Treaster, 2004). Importantly, it was in 1971 when Richard Nixon was president, and John Connally was Secretary of the U.S. Treasurer (Feldstein, 2013, World Gold Council, 2023). At that time, Volcker was Under Secretary of Monetary Affairs. At any rate, those three men were among those who advocated the suspension of the gold standard in the international payments system employed by the United States. There was the view that this was a difficult but necessary decision since using the fixed exchange rate of $35 per ounce of gold was causing a substantial drain on the gold supply of the United States (Feldstein, 2013; World Gold Council, 2023). Although this suspension did not officially eliminate the existing Bretton Woods system of international system of financial exchange, this suspension of one of its gold convertibility, in fact, rendered the Bretton Woods system inoperative. Even changing the convertibility rate to $38 an ounce would not be sufficient. And so, any policy of convertibility was dropped (Elwell, 2011; Oatley, 2019; Bordo, 2023).

Also, he was a visiting fellow at Princeton in 1974. From 1975 until he was appointed Fed Chair in 1979, Volcker was President of the New York Federal Reserve. (Shen, 2020). In 1979, Volcker ascended to the position of Chair of the Fed. (Committee on Banking, 1979, Shen 2020).

II. APPOINTED AS FEDERAL RESERVE CHAIRMAN

In 1979, Volcker became the 12th Chairman of the Federal Reserve Board. President Carter nominated him, and the U.S. Senate agreed; he came to office in a time of high inflation (Committee on Banking, 1979; Shen, 2020). The culprits that produced this high inflation rate are the Federal Reserve's loose monetary policy and the Arab oil embargo. In 1979, inflation rose to 13.3 percent annually (Shen, 2020). During both his Senate confirmation hearings and upon assuming office (Medley, 2013), Paul Volcker was appointed by Carter in the hope that a "banker's banker" would restore the world's confidence in the dollar and banks based in the United States (Epstein, 1985)

Volcker stated that he was going to pursue the tightening of the money supply (Medley, 2013). Upon arrival in his appointed office, Volcker immediately took steps in his crusade against inflation, which focused on a great slowing of the money supply (Goodfriend et al., 2005). The policy of tight money and high interest rates was purposely pursued by Volcker (Epstein, 1985). The result was large interest rates, as much as 21.5% (Hoffman, 1979; Shen, 2020.) Concomitant with this, unemployment increased to 10.8% (Shen, 2020). This period, around July 1981- November 1982, was a severe economic recession; however, the Great Depression was worse (Urquant et al., 1983; Sablik, 2013). Slower economic growth reduced demand for oil, somewhat diminishing the influence of OPEC on the United States. (Epstein, 1985). The Great Depression had an unemployment rate that peaked at about 25 % (Gordon, 2011).

The pattern of job losses during 1982 was an extension of the deterioration that characterized the economy of the U.S. in late 1981 (Urquhart et al, 1983). In the short run, there is the theory of the Short-run Phillips curve, with one example being the United States (Gentle et al., 2005). Volcker (2012) points out that not only should the monetary policy be examined, but also fiscal policy needs examination. Significant increases in defense expenditures and tax cuts resulted in substantial shortfalls in the federal budget. (Volcker, 2012). "The combination of growing federal debt and high-interest rates led to a substantial rise in the federal net interest costs" (Volcker, 2012). How this period of time fits into American economic history can be found in Gentle (2017).

Some Americans let their dissatisfaction with the Federal Reserve's policies be known in interesting ways. For example, some car dealers sent the Federal Reserve some keys to cars that they were unable to sell due to the high-interest rates; likewise, some indebted farmers on tractors blocked a Federal Reserve building (Shull, 2005; Shen, 2020). Amazingly, one man with a sawed-off shotgun made his way to the boardroom of the Federal Reserve "before being tackled by a security guard" (Shen, 2020). A "bodyguard" was assigned to Volcker (O'Sullivan, 2019). It was not uncommon for homebuilders to send him "blocks of wood" to highlight how the housing market was being negatively impacted by rising interest rates. (O'Sullivan, 2019).

It is important to explain the double-dip recession that occurred in the years 1980-82. Recessions can occasionally be followed by brief recoveries, which are then followed by new ones. We call this a twin recession. In this case, the second recession begins as soon as, or even before, and the economy completely recovers from the losses of the first recession because, for any reason, the recovery following the first recession lags after it ends (Alfano, 2022). A double-dip recession can be identified, for example, when the GDP moves from positive into a period of negative growth. Hence, there is a double-dip recession (Alfano, 2022). When the economy experiences a double-dip recession, it first experiences a recession before starting to recover, and then something unexpected happens to sabotage the recovery process. Major economic shocks, persistent debt deflation, novel government initiatives that discourage investment or create pricing rigidities, and declines in employment or manufacturing, for instance, can frequently trigger fresh recessions before an economy fully recovers. Crucially, the economy went through consecutive bouts of depression in the early 1980s, which coincided with the last double-dip recession to occur in the United States. From January to July of 1980, the economy contracted at an annual rate of eight percent. After it came a period of fast expansion, with the economy growing at an annual pace of slightly over 8 percent in the first three months of 1981. The next recessionary period for the economy was from July 1981 to November 1982. The economy subsequently started a phase of robust growth that lasted the rest of the 1980s. (Alfano, 2022).

III. GRAPHICAL ANALYSIS INCLUDING THE 1980-82 PERIOD

Three illustrations may aid in understanding what happened in the period around the 1980-82 Recession. In Figure 1, one can see that the highest rate of inflation occurred in 1979 and that overall, it fell after that due to the disinflation policy purposely pursued by Volcker. Two high points of inflation occurred, especially in the times circled in Figure 1. Moreover, Figure 2 displays the prime interest rate. The disinflation caused the prime rate to increase in the short run. This seemed to be the only way to quell inflation. Figure 3 provides the unemployment rates during this time period. Recessions may be characterized by higher unemployment levels. This can be seen in Figure 3.

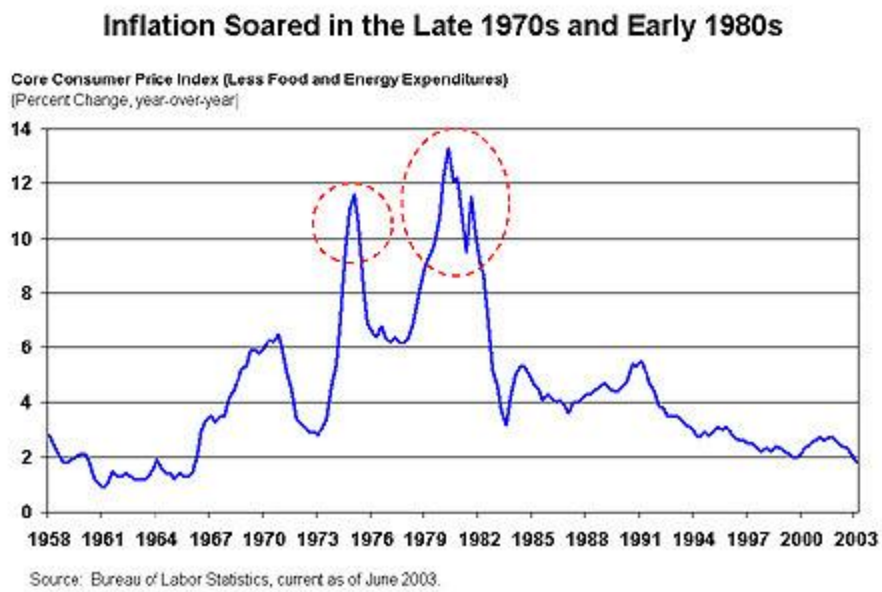

Figure 1: Inflation rate of the United States

Source: *Bureau of Labor Statistics*

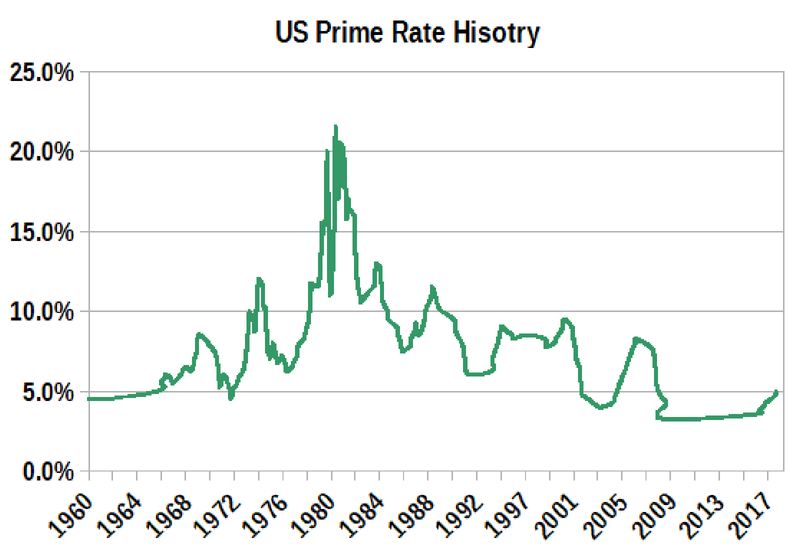

Figure 2: U.S. Prime Rate Source: A Guide to Student Loan Interest Increases (May 2023)

A Guide to Student Loan Interest Rate Increases (May 2023) (badcredit.org)

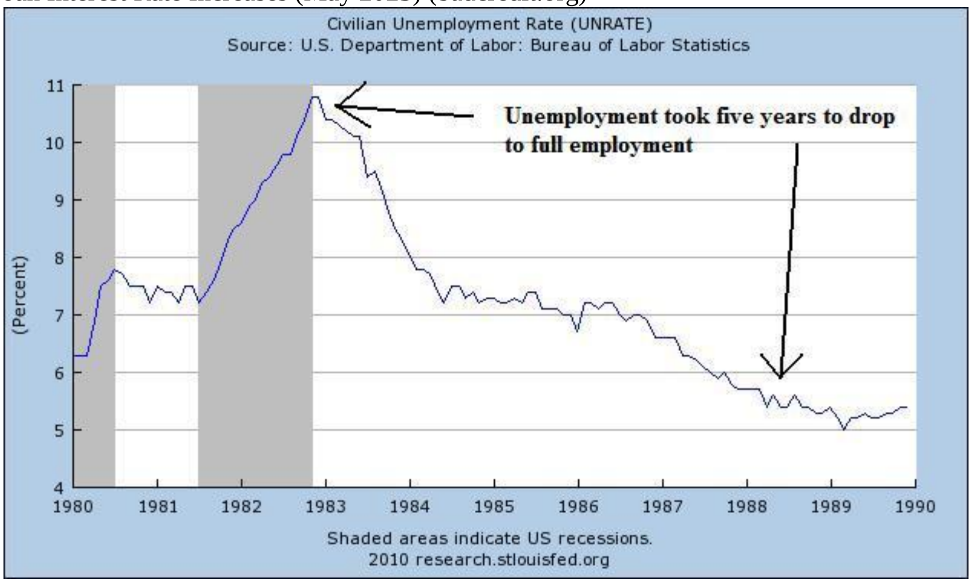

Figure 3: The unemployment rates in the U.S. Source: St. Louis Federal *Reserve Bank; U.S Department of Labor.*

Unrate+4.JPG (630×378) (bp.blogspot.com)

IV. AFTER THE DISINFLATION POLICY

Volcker's desire to fight inflation was great, even if his actions put the U.S. through a temporary economic downturn (Perelman, 2012). By the end of his first term as Federal Reserve Chair, Volcker had managed to get the inflation rate to drop to about for percent (Shen, 2020). The end of his second term was on August 11, 1987. At that point, Volcker was replaced by Alan Greenspan. Noble-prize-winning economist George Stiglitz has stated, "Clearly, we need not only re-regulation but a redesign of the regulatory system. During his reign as head of the Federal Reserve, in which this mortgage and financial bubble grew, Alan Greenspan had plenty of instruments to use to curb it but failed. He was chosen by Ronald Reagan, after all, because of his anti-regulation attitudes" (Gardels, 2008).

V. VOLCKER AS A POST-FEDERAL RESERVE CHAIRMAN

After his two terms as Federal Reserve Board Chairman, Paul Volcker continued to make a significant impact on public and private life. In 1987, Volcker became Chairman of the "prominent New York investment banking run by James D. Wolfensohn." Later, Wolfensohn became president of the World Bank (Applebaum et al., 2019; Monet, 2019). Volcker belonged to numerous international organizations and received a multitude of honors and honorary degrees, including membership in the American Academy of Arts & Sciences (Academy of Arts and Sciences, 1992). He also was chair of an Independent Committee to examine the unfinished stories of Holocaust victims who were Jews (World Jewish Congress, 2019). He was picked to investigate possible corruption in the Iraqi Oil for Food program. (Gardiner, 2005). He was involved in many other areas of investment banking, including international economic and monetary affairs. Also, he influenced some of the international accounting standards. He is credited with helping the prestige of the Federal Reserve Banking system. There is so much more that can be said about Volcker's post-Federal Reserve Chairman career, but to list all of that is beyond the scope of this article. However, it should be highlighted that President Barack Obama appointed Volcker to head the President's Economic Recovery Advisory Board (Bohan,2009). (1) The handiwork of Federal Reserve Chairman Allan Greenspan and the handiwork of politicians who agreed with him provided the drive for deregulation in much of the financial sector. Many economists think this is at least partially responsible for the Great Recession.

VI. SUMMARY AND CONCLUSION

This article provides a summary of some of the major events in the life of Paul Volcker, the 12th Federal Reserve Board Chairman. Volcker earned his Bachelor's at Princeton University and a Masters from Harvard University. He also studied at the London School of Economics. He had work experience as an economic analyst in both the public and private sectors. He also had administrative roles in the U.S. Treasury and the New York Federal Reserve Bank.

Ultimately, he became the Federal Reserve Board Chairman. His policy of pursuing disinflation caused both unemployment and interest rates to rise in the short run. Volcker's steadfastness in lowering the inflation rate is, in a sense, famous. This determination came about during Volcker's tenure as Chairman of the Federal Reserve.

The President's Economic Recovery Board made a number of recommendations. One came to be known as the Volcker Rule. "The Volcker Rule aims to protect bank customers by preventing banks from making certain types of speculative investments that contributed to the 2007–2008 financial crisis" (Chen, James, 2022).

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