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From dollar float to inflation fight

Presidential priorities over years ranged from ending gold standard for Nixon to Carter's aim to cap soaring prices

Nixon Shock

Aug. 15, 1971 (Sunday) 9 p.m. - President Richard Nixon made a televised announcement about new economic policies from the Oval Office in the White House.

The core of his policies was to take the U.S. off the gold standard. As well, Nixon said he would implement a 10% import surcharge on textile products. The president, who had made an election pledge to protect the American textile industry, was irritated at Japan because it would not agree to limits on textiles exported to the U.S.

Would Americans be humiliated by going off the gold standard? This was the sort of thing I had worried about over the several months spent working on the policies.

That day Nixon was able to position this move as a new starting point. I was impressed by the skill of this veteran politician.

Most officials in charge of dealing with the U.S. in countries that would be most affected were not informed of the content of the speech just before it was given. For Japan, Yusuke Kashiwagi, an adviser to the Ministry of Finance, was our negotiating partner for finance and currency problems, and I informed him.

Volcker holds an animated discussion with President Nixon at a White House meeting in this undated photo.

I'm sure that Kashiwagi was surprised. I wish I had been able to warn him, my good friend well ahead, but there just wasn't enough time.

I had wanted to inform Kashiwagi and my counterparts in other major countries the day before the speech, but President Nixon did not allow it. More than anything, the president feared that the new economic policies would be leaked beforehand.

At the time, Kashiwagi had already retired from the Finance Ministry, but on the occasion of Nixon's speech, he returned to the front lines. In December 1971, until the Smithsonian Agreement was completed, which entailed many currency adjustments with the devaluation of the dollar as an axis, we met frequently.

Kashiwagi, who spent his youth in New York, had polished English skills. He took the lead in the process of returning Japan to the world of international finance in the postwar period.

Kashiwagi was also instrumental in seeing that a MOF official was positioned as vice minister in charge of international affairs, thus ensuring an excellent successor. We continued to be friends even after he became involved with managing Bank of Tokyo (now Bank of Tokyo-Mitsubishi).

I heard of Kashiwagi's death on the morning of Sept. 3. Deeply saddened, I wrote a letter of condolence to the Kashiwagi family condolence to the Kashiwagi family.

Floating exchange rates

One aspect of the Smithsonian Agreement began falling apart in 1972.
With the deterioration of the balance of international payments, the
pound sterling was inundated by speculative selling, and was moved to a floating exchange-rate system on June 23.

In early 1973, the Italian lira was heavily sold due to government turmoil. Furthermore, the dollar was also becoming the target of much speculative selling. This was because the exchange-rate adjustment in the Smithsonian Agreement was smaller than we had estimated, and the U.S. balance of international payments was not improving enough.

At the beginning of 1973, President Nixon abolished the regulation of wages, and inflation was in the air. John Connally was replaced as secretary of the Treasury by George Shultz, who was market-oriented. I wrote a memo to Secretary Shultz on "Reconsidering the exchange-rate realignment."

The key was the yen currency of Japan, which had an enormous trade surplus. Appreciating the yen 10% against gold, and devaluing the dollar 10% against gold would mean that the yen would have appreciated by 20% against the dollar. European currencies would remain stable against gold and appreciate 10% against the dollar.

After testifying before Congress on Feb. 7, 1973, I took a flight to Tokyo. After my plane took off, President Nixon made a courtesy call to Prime Minister Kakuei Tanaka to let him know that I was on my way. On the evening of Feb. 8, I arrived at Yokota Air Base, contacted Kiichi Aichi, the Finance Minister, and we made an appointment to meet.

Late that night, we had a vigorous two-hour discussion at his official residence in Tokyo. I told him about my 10%-plus-10% idea, and put pressure on him by saying, "If we cannot reach an agreement with Japan, there is no point in me going to Europe." Aichi insisted that a 20% appreciation of the yen against the dollar was too much. Instead, he proposed that the yen move to a floating exchange-rate system.

"If the yen is floated, the markets will probably appreciate it by 20%," he said. That is what I thought too, and I was satisfied. Aichi had an international point of view; he was a skillful, decisive finance minister.

The U.S. Armed Forces have a regulation about pilots getting a certain amount of rest time. I was unable to take off. Washington was quickly contacted, the secretary of defense awakened, and we received permission to take off, but we wasted several hours.

On Friday at 8 p.m., as I landed at the airport near Bonn, German Finance Minister Helmut Schmidt left on a flight to Paris. I had wanted to first meet with Schmidt, and then ask him to convince Giscard d'Estaing, his counterpart in France.

The next day, after I communicated the U.S. proposal to Schmidt in Bonn, I flew to London, got the support of the British, and then spoke with d'Estaing. On the condition that Japan agreed to revalue the yen, the European countries agreed to the realignment of exchange rates. Negotiations with Japan and in Europe took five days, ending on Feb. 12.

That day, the U.S. announced that the dollar would be devalued by 10%. By switching the yen to a floating exchange rate, the Japanese currency appreciated, and a sufficient realignment in exchange rates was realized. Joint intervention in gold sales to prevent a steep rise in the price of gold, however, was not undertaken. That was a mistake.

Through March, the price of gold rose rapidly, and that knocked the psychological props out from under the dollar. Since then, all the major currencies have been left to float.

Fed chairman

"Good morning, Volcker!" I got the call at my apartment in New York just after 7 a.m. on July 25, 1979. "Will you take over the chairmanship of the Fed?" asked President Jimmy Carter.

After Volcker, on President Carter's left, was installed as chairman of the Federal Reserve in August 1979, he and his family pose for a commemorative photo in the Oval Office.

At that time, government policy on economics was being made by the combination of Secretary of the Treasury Michael Blumenthal and Fed Chairman William Miller. Blumenthal had resigned, and Miller was installed as secretary of the Treasury. The next step was selecting the new Fed chairman, but the search was proving difficult. The president had planned to choose someone from the private sector, but he was not getting a favorable response.

In 1979, consumer price increases reached the 13% percentile range, a double-digit surge, so it was clear that the chairman was going to have a difficult job. Apparently I was recommended based on the experience I had both in Washington and New York.

"The first order of business is going to be calming down inflation. Strong government measures are going to be required to control inflation. If I am appointed chairman of the Fed, I will want to take those measures," I said, speaking candidly with President Carter in our discussion.

Along with pushing to curb inflation, I also emphasized, "the importance of the independence of the Fed." Overwhelmed by the voices of politicians who hated financial belt-tightening, the measures to fight inflation had all been designed to appease them, and I believed that this had led to a double-digit increase in the cost of living.

"The president will most likely decide Volcker is not the person he is looking for," I thought.

That evening, I had dinner with my old friends Robert Kavesh and Lawrence Ritter, both professors at New York University. "I won't be chosen," I told them.

I received the call from the president the next morning. Understanding my ideas, the president said that the chairmanship of the Fed was the most important job for someone like me who had long been involved in financial and economic policy. I had no trouble accepting the president's request.

The whole Volcker family, that is, my wife and children, received invitations to the White House for my installation as chairman of the Fed on Aug. 6.

After becoming chairman, I spent many of my weekends in New York with my wife. She was able to make a number of trips to Washington. As I became busier, I was not able to get back to New York as often as I liked, and my wife made fewer trips as her arthritis got worse. I still managed to find ways to spend time at home. My years as Fed chairman were difficult ones for my family.