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The Director

C[illegible] Intelligence Agency

Washington, D.C. 20505

14 JUL 1977

Dear Vince:

Just a note to thank you for your several July notes. Nothing new on the reorganization front but I appreciate your 8 July advice. The Post this morning would have our decks awash but I think our hull integrity is still in pretty good shape for the time being.

Yours is the only reaction so far to the USNIP article. We are hopeful it will stimulate some reasonable exchange of views in the community. We've decided to let the Keegan article lie - his arguments are the same old ones and I see little profit in generating greater interest in them through a debate.

On the public lecture, I think spring semester looks best all around. Shall leave it to you to suggest some alternative dates.

Thanks again for all your help.

Yours,

Stan

STANSFIELD TURNER

Professor Vincent Davis
The University of Kentucky
Lexington, Kentucky 40506

P.S. We're at a lull in the storm, but I expect a decision soon, after Brown returns from Korea - 1 Aug. Stan

STAT

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77-7-14

The University of Kentucky
Lexington, Kentucky 40506 U.S.A.
(606) 257-4666

8 July 1977

Vincent Davis, Director
Patterson Chair Professor
of International Studies

MEMORANDUM

TO: The DCI

FROM: Vince Davis

SUBJ: Next moves (re: recent OMB high-level comments)

Jim Taylor advises by phone that your recent meeting with the OMB boss was discouraging, with the OMB man focusing only on the immediate political problems for the President ("awkward") if two of the key Cabinet people are squabbling. So, I gather, the OMB man has joined the ranks of those seeking a bastardized compromise, referring you to Jaynes.

My advice: (1) DON'T PANIC...DON'T RETREAT. If it ultimately comes to a compromise, make somebody else force it on you, but then accept it with good grace.

(2) SEEK A PRIVATE SESSION WITH THE PRESIDENT, preferably one-on-one without ZB or other aides on either side. It had to come to this sooner or later, and now is probably the time. Elaborations follow.

You obviously don't want to seek private access to the President very often, but this is a MAJOR ISSUE--in my judgment, one of the most critical issues of recent times. He gets paid to make the tough decisions, and he's shown (with Andy Young, and on the B-1 bomber issue) that he does not back away from the tough ones, and that he does not seek middle ground just to placate critics in the Cabinet or elsewhere. He may in fact be disappointed in you if you don't fight for this one all the way.

If he thinks it's "awkward" to have a DCI and a SecDef in dispute, explain to him what AWKWARD really means. It's awkward when (in '52) a fragmented intelligence system gave faulty intelligence to the President (in '50) on Korea, and drove the Democrats from the White House. It's awkward when a fragmented intelligence system gave bad advice on Vietnam in the '60's, and again drove the Democrats from the White House in '68. It's awkward when a fragmented intelligence system contributed to the abuses of the early '70's, and helped to

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chase two successive Republican presidents from the White House. You can think of many similar horror stories resulting from a badly managed and fragmented intelligence network over the past 30 years. The next big intelligence failure could mean not just the demise of the Carter Administration but NATIONAL SURVIVAL. This is what "awkward" should mean to a president, which makes a DCI-SecDef disagreement appear quite minor in comparison.

Oh, yes. Don't take that advice to talk to Jaynes, unless he wants to visit you, and even then I would turn him over to Taylor. Don't compromise your dignity by getting into details with an OMB flunky.

The only thing that encourages me in all this is that I think you have a superb team in John McMahon, Jim Taylor, Barry Kelly and [redacted] working on this problem for you--with whatever extra help you can get from Graham Allison. Stick with these good people--they are giving you very good support and advice. And... DON'T GIVE UP THE SHIP.

STAT

[See, you didn't really rid yourself of my gratuitous advice, just because I left town.]

Info copy: Jim Taylor

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The University of Kentucky
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8 July 1977

Vincent Davis, Director
Patterson Chair Professor
of International Studies

MEMORANDUM

STAT
STAT

TO: Stan Turner
and [redacted]

And congratulations again to [redacted] on 0-6 selection!!!

FROM: Vince Davis

SUBJ: Congratulations!!! on your article in the July USNIP

It's a solidly reasoned and appropriately analytical piece that the two of you have co-authored on countering the Soviet threat in the Med. However, I am less sanguine than you are as to our capabilities for meeting the first and the third of your "four key points" summarized at the end of your article. On your third point (assistance to ground commanders), I recall that the Navy constantly assured the Army in the 1930's that the fleet could steam to the rescue of the garrison troops in the Philippines within three weeks following a possible surprise attack by the Japanese. But, as it turned out, the Navy needed something more like three years to redeem MacArthur's "I shall return" promise. So, I hope that your current optimism on the Med situation is well-founded. Meanwhile, I am sure you can find time to whip out a quick rebuttal to George Keegan's op-ed page article in the New York Times of 6 July...and I look forward to reading your rebuttal.

* * * * * * * * * *

Stan, at our recent lunch in your office, you asked me how I was doing in my "fight with the Navy" to develop a greater appreciation for the Naval Reserves. The Navy never won a war without the Reserves but, unfortunately, it always takes another war to impress this point on the Regulars--most of whom never see a Reservist. So, I can never "win" in this "fight." It's the same story in another fruitless struggle that I have waged with the Regulars for almost 20 years, brought to mind now by another article in the July USNIP. See the attached copy of a letter to Captain Bouffard. As Assistant Navy Secretary F. D. Roosevelt said once in the 1920's, "Trying to reform the Navy is like fighting a feather bed--you punch it and punch it, but it always looks the same." (Or words to this effect.)

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The University of Kentucky
Lexington, Kentucky 40506
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Vincent Davis, Director
Patterson Chair Professor
of International Studies

8 July 1977

Captain Edward N. Bouffard, USN
Professor of Naval Science and
Commanding Officer NROTC Program
University of Minnesota
Minneapolis, Minnesota 55455

Dear Captain Bouffard:-

I am writing merely to express my very strong agreement with (and therefore my emphatic applause for) your article on the NROTC in the current July 1977 issue of the U.S. Naval Institute Proceedings.

I have been fighting this same battle in various forms since 1959 when I was a young faculty member at Princeton. But the struggle is much older within the Navy than any of us now involved. It's important to remember that Mahan was widely scorned if not ignored in the Navy because Mahan thought it was useful for officers to be educated in subjects going well beyond scientific, technological and engineering fields. Mahan was "put out to pasture" when he was assigned to the Naval War College, as far as the U.S. Navy was concerned. Indeed, Mahan was promoted to rear admiral only on the basis of a "tombstone law" stemming from the Spanish-American War. And Mahan did not become a "hero" in the U.S. Navy until he had gained wide acclaim in European naval circles. Even now, many U.S. naval officers pay lip-service homage to Mahan without having read a single word that Mahan wrote. Most naval officers have a technological/engineering orientation, and those kinds of people do not do very much reading in the literature of geopolitics, strategy, world economics, etc., unless forced into it while students at a war college.

I am not even convinced that the late Rear Admiral James L. Holloway, Jr. ("the father of the modern NROTC") truly believed the fine sentiments which you quote on page 42 of your article. Those nice words may have been political "window dressing." At the end of World War II in 1945-46, the Navy predicted an annual need for more young ensigns than the Naval Academy could produce. Representatives and Senators from almost all of the major coastal cities in the U.S. responded to this need by introducing more than a dozen bills in Congress, each designed to establish additional

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new "Naval Academies" in places like Boston, Philadelphia, Charleston, Savannah, Jacksonville, New Orleans, Galveston, San Diego, Los Angeles, San Francisco, Seattle, etc. Of course, these proposals horrified the flag officers of that period, almost 100% of whom were alumni of THE Naval Academy at Annapolis. Those admirals did not wish to see their Alma Mater fragmented into a dozen or so separate naval academies. Holloway introduced the NROTC idea as a politically attractive alternative, originally creating 52 units--or at least one in almost every state of the Union. This scheme placated almost all Representatives and Senators.

But, if we credit James L. Holloway, Jr., with at least some degree of sincerity and conviction in dreaming up the post-1945 version of the NROTC idea, it's unfortunate to note that his son "Jimmy Three-Sticks" lacks the vision and the political savvy of his father.

If I could ever be of assistance to you in your efforts in this struggle, do not hesitate to call on me. However, I have become very frustrated and a bit cynical about it. My professional work puts me in close contact with many flag officers, and I try to use some of those contact occasions to wage this struggle. But trying to tell an engineering type that he needs to know something about politics and economics and history is ordinarily fruitless.

On a personal note, I am sure that you must know many of my friends on the faculty at the University of Minnesota--for example, my old pal Hal Chase in Political Science (and a major general in the USMCR).

Feel free to share copies of this letter with anybody who might be interested.

Cordially,

Vincent Davis
Director of the Patterson School
and Patterson Chair Professor
[also, Captain, USNR-R, for 10
years a carrier aviator, and
for 15 years in naval intelligence]

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77-7-14

The University of Kentucky
Lexington, Kentucky 40506 U.S.A.
(606) 257-4666

6 July 1977

Vincent Davis, Director
Patterson Chair Professor
of International Studies

MEMORANDUM

TO: Stan Turner

FROM: Vince Davis

SUBJ: A lecture by Stan Turner in Lexington, KY

You asked me how it would be if you gave a public lecture here under our auspices on Thursday evening, 10 November, prior to your appearances the next day at nearby DePauw and Wabash in Indiana. I said that I would check our calendar here, and get back to you.

Very sorry!--but 10 November is the date for Paul Volcker's guest lecture for us, a date that we finally nailed down with him last April after about four years of trying. Thus, I would be hesitant to go back to Volcker now with a rescheduling proposal for him. He is one of the two or three most important men in the world in the area of international finance, money, and banking--and he may be President Carter's choice to succeed Arthur Burns as the next Chairman of the Fed. (See attached xerox copies.)

OTHER POSSIBILITIES:

(1) Lecture here on Wednesday evening, 9 November, perhaps also talk for 20 minutes at lunch to the Rotary Club on Thursday (Rotary is the most influential "elite" civic club in Central Kentucky, with about 350-400 men on hand for lunch each Thursday), stay over Thursday to help us welcome Volcker if you wish. Disadvantages: (a) for you, it would take you away from your office one extra day (Thursday and Friday, rather than Friday only); (b) for us, we prefer not to have back-to-back VIP lecturers on successive evenings.

(2) Lecture here on Wednesday or Thursday evenings, 12-13 October, doing the Rotary Club at noon Thursday too if you wish, and remaining for our Patterson School Board of Advisors (BOA) fall meetings with BOA members arriving on Thursday evening for the Friday-Saturday meetings.

(3) Our preference: Some other time, not in connection with any

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other event on our calendar, so that we can give our undivided attention to your visit. Wednesday or Thursday evenings are ordinarily best from our perspective, for VIP guest lectures. The last three weeks of September are clean on our calendar thus far. The bad dates for us in October are 14-15 (BOA), 20-22, and 24-29. The bad dates for us in November are 8 (Election Day), 10-11, 15-16 and all dates later in November. December is no good at all, with the end of semester and the holidays. Spring semester starting in mid-January is a whole new ballgame, with much clear time on our calendar as of now.

MISCELLANEOUS INFORMATION:

(1) It's about 225 miles, or 4 hours driving time, from Lexington to DePauw (I have a colleague here who drives it often)--in case you still want to try that connection in November as per Other Possibility #1 on page 1 of this letter. It's about 45 minutes driving time from DePauw to Wabash.

(2) It's possible, if you felt necessary to squeeze it, to give a public lecture here some evening without missing a working day from your office. You could fly over on Eastern #261 departing Washington National about 1600, arriving here 1710, have a dinner with us, lecture at 2015 until about 2200 (including Q&A), a small reception from 2215 until about 2330, to bed by midnight, and fly back the next morning on Eastern #504 departing Lex at 0800 and arriving Washington National at 0910. BUT we would very much hope that you would not need to rush it this much, so you could spend some of the next morning in small sessions with students plus perhaps a Rotary lunch if on a Thursday.

(3) Piedmont offers Lexington-Washington service with a stop in Roanoke, but Eastern offers our best non-stop service, as per:

Eastern #261 --	Lv Wash 1559		Eastern #655 --	Lv Wash 2040	
	Ar Lex 1710			Ar Lex 2151	
Eastern #504 --	Lv Lex 0800		Eastern #256 --	Lv Lex 1706	
	Ar Wash 0910			Ar Wash 1811	

(4) Regardless of anything said above, we will "move heaven and earth" to accommodate your preferences, if at all possible. I think we can assure you an audience of at least 750-1,000 for a DCI public lecture here, but these are hard estimates to make. I guessed 1,500 for Gerald Ford's lecture for us in April, and we had SRO with 11,000 seated.

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FEDERAL RESERVE BANK OF NEW YORK
NEW YORK, N.Y. 10045
AREA CODE 212 791-6173

PAUL A. VOLCKER
PRESIDENT

April 27, 1977

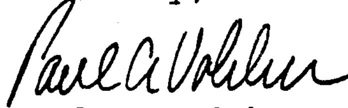
Mr. Vincent Davis
Director
Patterson Chair Professor
of International Studies
The University of Kentucky
Lexington, Kentucky 40506

Dear Mr. Davis:

As promised, I have looked over my calendar for some possible dates in the fall when I could travel to Lexington. October 13, November 10 and December 8 seem to be not only the most convenient times for me, but perhaps the only Thursdays. I'll hold all three dates until we hear from you.

Best regards.

Sincerely,



Paul A. Volcker

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The University of Kentucky
Lexington, Kentucky 40506
(606) 257-4666

Vincent Davis, Director
Patterson Chair Professor
of International Studies

May 6, 1977

President Paul A. Volcker
Federal Reserve Bank of New York
New York, New York 10045

Dear President Volcker:-

We were delighted to get your good letter of April 27.

Among your indicated dates, November 10 is best for us, indeed, ideal. So, it's a date and a deal. Thanks!

We will be back in touch with you in September or early October to nail down a few particulars. Meanwhile, let me stress again that we will want you here in time for an informal little supper on that Thursday evening before your lecture at around 8:15 or 8:30 p.m., and we will want you to remain through lunch on Friday. Also, state your usual fee for this sort of thing, and we will happily meet it.

Best regards,

Vince

Vincent Davis

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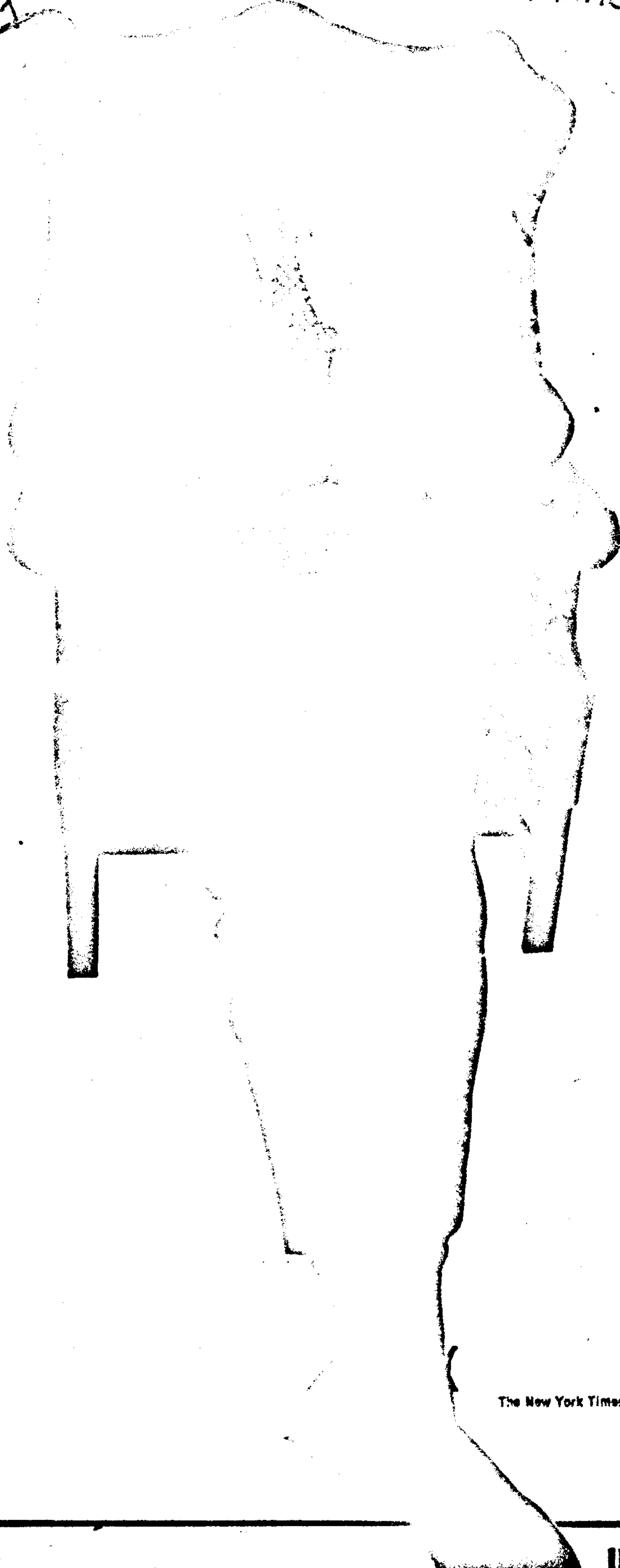
Paul Volcker Speaks Out

Sec. 3 p. F-1 DEC. 19, 1976 — N.Y. TIMES



The New York Times/D. Gorton

By PAUL LEWIS

Paul A. Volcker, the lanky, cigar-smoking President of the Federal Reserve Bank of New York, is one of the most experienced players left on the pitted and muddy playing fields of international finance.

As Under Secretary of the Treasury for Monetary Affairs from 1969 to 1974, he was in the thick of the fray as the dollar was devalued, the Bretton Woods monetary system was overthrown and the world staggered from fixed to floating currency exchange rates.

In his present position, he heads what traditionally has been regarded as the most presitgious of the Federal Reserve System's 12 regional banks, with responsibility for the conduct of United States foreign exchange policy and the management of the dollar on international markets. Mr. Volcker was named president of the New York Fed in August 1975, after the retirement of Alfred Hayes.

After last month's Presidential election, the 6-foot 7-inch Mr. Volcker was tipped as a possible Treasury Secretary in the Carter Administration. His failure to get this post has heightened speculation that Mr. Carter may appoint him the next chairman of the Federal Reserve Board in Washington when the present incumbent, Dr. Arthur F. Burns, steps down in 1978 after his term expires. Politically, Mr. Volcker calls himself an independent.

At 49 Mr. Volcker also is that rarest of creatures, a central banker willing to speak his mind clearly on the issues of the day and in public. In a recent interview, just as the ministers of the oil-producing countries were gathering in Qatar to debate another price rise, Mr. Volcker said outright what many Western leaders are still saying only in private.

This is that the strains created in the world economic system by the oil price increases that have already taken place remain serious and that further coordinated action may be necessary to deal with them, even without any further increases. Specifically, Mr. Volcker suggested:

¶New international arrangements to insure that all countries can get the money they need to pay their oil bills, including the possible revival of the "financial safety net" proposed by Secretary of State Henry A. Kissinger last year but never acted on by Congress.

¶An early tax cut to revive the flagging American economy and create a more expansionary international environment in which the tensions created by the oil price increase would be easier to resolve.

¶A more cautious approach by American banks toward foreign lending and closer monitoring of their operations by Federal Reserve and other regulatory bodies.

INSIDE

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Paul Volcker Speaks Out on Oil Prices, Tax Cuts

Reviewing the international outlook from the vantage point of his paneled dining room in the Fed's gloomy Florentine palace on Liberty Street not far from Wall Street, Mr. Volcker points out that at present price levels the oil exporting countries are taking in some $40 billion a year more from their customers than they can spend on goods and services imported from them—and that this figure will decline only slowly.

This means that the oil-importing nations are saddled with a payments deficit of equivalent magnitude—$40 billion—which they can shift around among themselves, but which they cannot get rid of altogether.

"If the oil deficit was spread out evenly and fairly", Mr. Volcker says, "we could probably keep going for some time." But it isn't. "The deficits are becoming heavily concentrated on some countries", he goes on, "and often on those least able to bear them," a reference to the developing world and the weaker industrial nations like Britain, France and Italy.

For instance, the latest forecasts by the Paris-based Organization for Economic Cooperation and Development suggest that the developing nations will shoulder about half of the oil deficit next year, just as they are this year, with the richer countries taking up the rest of the burden.

Meanwhile, Britain is likely to pile up another $2 billion in debts next year on top of the $3 billion incurred in 1976, while France may add a $4 billion deficit to the $5.5 billion deficit expected this year. Germany, however, could see its surplus swell from $4.5 billion to $6.5 billion, although it has no oil of its own.

So far, as Mr. Volcker points out, debtor nations have been able to raise the funds they need by borrowing from banks and in the private capital markets. But while "private intermediation worked well to start with," he says, "we can't persist in this pattern. Unsustainable tensions are building up."

Simply put, Mr. Volcker's point is this: at the present the oil exporters are putting their surplus finds into private banks and capital markets that must then take the risk of lending them on to countries in deep balance-of-payments deficit—in large part because of the oil price increase.

At first these intermediaries were prepared to do this. But the time is approaching when it may no longer be a prudent risk. Mr. Volcker says he had expected to see a slowdown in private lending to deficit countries this year, although it has not occured. He now thinks that private lenders will grow "much more selective" in the year ahead.

But if oil importers cannot finance their deficits, they will be forced to adopt such disruptive measures as import controls, which will only pass along their share of the oil deficit to someone else. "Changing the deck chairs on the Titanic" is the graphic phrase used to describe this process by the staff of the National Security Council in Washington.

So Mr. Volcker suggests that some form of "internationally supervised credit" might be necessary to tide the world over until the oil exporters have learned to spend their funds and the importers have developed now alternative energy supplies of their own.

The most ambitious such scheme was Mr. Kissinger's financial safety net, under which the industrialized countries of the world were to stand ready to bail out any of their number denied access to the private credit markets.

The proposal died a lingering death in Congress last year, but Mr. Volcker says that "personally I would feel a lot more comfortable" if it were revived by the incoming Administration. He adds that the same job could be done through a big expansion of the lending facilities of the International Monetary Fund, which are due to be reviewed next year.

Any such new credit schemes, he adds, should have appropriate strings attached—"strict conditionality" is the technical phrase—because the international community cannot be expected to finance spendthrift domestic policies and the debtors must be encouraged gradually to balance their books.

Reducing international financial imbalances is always easier when the world economy is growing and trade is on an upswing than in a static environment. And Mr. Volcker suggests this is one additional reason why the incoming Carter Administration should consider a more stimulatory economic policy at home.

"It's important for the health of the world that a handful of the stronger countries have a reasonable expansion," he says, "though this does not tell you how to do it without creating more inflation."

But so far as the United States is concerned, Mr. Volcker's views are reasonably clear-cut. He says outright that "the economy is not performing as satisfactorily as one would like." The concern about a too-rapid recovery expressed at the Western economic summit in Puerto Rico last summer seems "to be diminishing, to say the least."

His preference is for an income tax reduction in view of the American economy's "present anatomy"—relatively slow growth in personal income and weak capital investment.

As a member of the Federal Reserve's Open Market Committee, which tries to control the growth of the na[illegible] money supply, Mr. Volcker is relu[illegible] [illegible] publicly about [illegible] policy, partly because his comments could have an impact on the financial markets.

But he seems to side with the committee chairman, Dr. Burns, in believing that a faster rate of monetary expansion would be an unhealthy way to stimulate economic activity. Mr. Volcker insists that he is not a true "monetarist," in the sense of believing that control of the money supply is the alpha and omega of economic policy.

But he concedes grudgingly that there may be "more than a grain of truth" in the monetarists' contention that pumping new money into the economy will only pump up inflation. In other respects, Mr. Volcker's relations with the strong-willed Dr. Burns provoke innumberable, fascinating questions—all of which he politely declines to answer.

To some observers, it is ironic that a man who was once a power in his own right in the Treasury should now find himself a subordinate of Dr. Burns. It is also true that the New York Fed traditionally has hewn an independent line from the Federal Reserve Board in Washington and that relations have sometimes been strained in the past.

Today Mr. Volcker speaks tactfully of putting the differences of the past behind him and cooperating closely with Dr. Burns and Washington. But it is hard to believe that he would not speak his mind, particularly on international affairs, where his experience is strongest and Dr. Burns may be at a comparative disadvantage.

The more buoyant domestic economy that Mr. Volcker hopes to see next year would help the banking industry, which in part has been forced to step up its lending to deficit-ridden foreign countries by the weakness of loan demand at home. However, Mr. Volcker believes that the regulatory authorities need to keep a much closer eye on the banks in the future, even though they seem to have weathered the worst of the storm. "Banking regulation is a sleepy business", he says, "it takes a shock like the 1930's to wake people up."

The bankruptcies and sour loans of the last few years have played the same role as the Great Depression, in his eyes, and Mr. Volcker wants to see the New York Fed "out in front in the bank supevisory effort." He points with pride to the leading role played by his bank in developing a new "early warning system" that the Federal Reserve system is building in an effort to identify troubled banks in the future before their troubles get serious.

Yet the president of the New York Fed also wants to be loved—as well as feared—by the private bankers. He already describes himself as more of an "activist" than his predecessor, Mr. Hayes, with a heavier burden of public speaking. Mr. Volcker also sees himself as a link between New York's financial community and the Federal Government [illegible] Washington.

While he has no wish to share the Bank of England's reputation for being in the hip pocket of private financial institutions, he still believes that the New York Fed should play something of the same role as the old Lady of Threadneedle Street in acting as a go-between for the Government and the [illegible]

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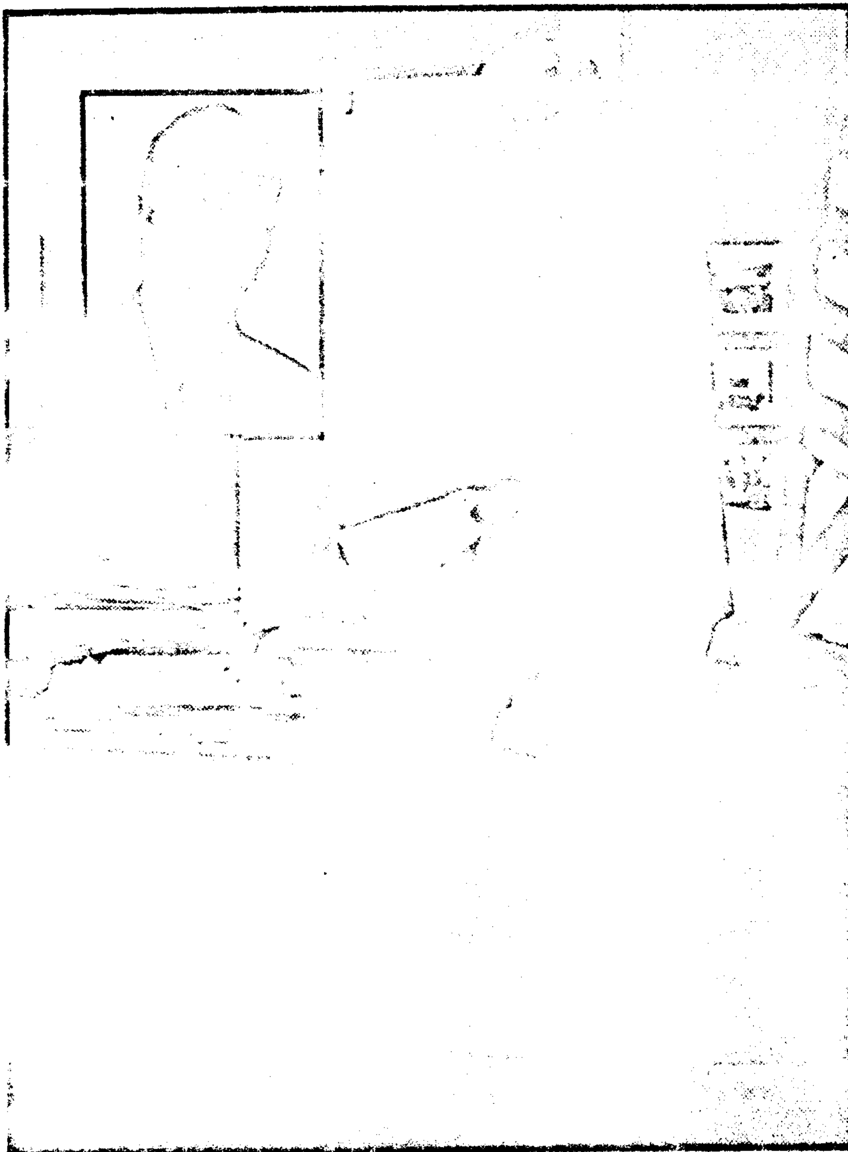
Mr. Volcker's background is impeccable for any central banker. Born in New Jersey in 1927, he graduated from Princeton, took his master's degree from Harvard and did postgraduate work at the London School of Economics. After a stint with the New York Fed's research department, he moved to the Chase Manhattan Bank in 1957, became vice president in charge of planning and then moved on in 1961 to the Treasury in Washington.

He is so tall that he is humorously described as being twice as high as the monetarist economist, Milton Friedman, though not quite as towering as the crypto-socialist, John Kenneth Galbraith. His stature gives him a degree of personal prominence that central bankers are supposed to abhor.

He differs from the central banking norm in another way, in that he is one of the few who have ever had policy-making experience in a national treasury. He thus has spanned the world of the politician, whose economic decisions are tempered by expediency, and that of the central banker, who is supposed to stand aloof from politics.

Ironically, Mr. Volcker was one of the key policy-makers in the Treasury Department who helped strip the New York Fed of some of its most imprtant functions when the old Bretton Woods system of fixed currency exchange rates was abandoned by international agreement in 1971. Without the need to maintain fixed parities among the world's currencies, the New York Fed's stature has diminished.

So while Mr. Volcker may dream of restoring to the bank some of its former power and prestige, the banshees that wander its marble corridors in lower Manhattan still call him the man who took away its former glory in the first place.



The New York Times

There is speculation that Mr. Volcker will replace Arthur F. Burns, chairman of Federal Reserve Board when the latter's term ends in two years.

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N.Y. TIMES — SEC. 3
Apr. 14, 1974 — p. 3

Volcker's Monetary Legacy

Promising Experience In Currency Floating

By EDWIN L. DALE Jr.

WASHINGTON — The impending departure of Paul A. Volcker as Under Secretary of the Treasury for Monetary Affairs provides an occasion to reflect upon the most turbulent period in international monetary affairs since the Great Depression and on the legacy that this turmoil has left.

Mr. Volcker lived this age—he did not create it. While his influence was great, and while he helped to shape some important decisions, he would be the first to concede that massive forces at work in the world were more important than government decisions in determining what happened.

Only a few other men have lived through the entire period since early 1969 in positions of authority—Otmar Emminger of West Germany, Valéry Giscard d'Estaing of France, Guido Carli of Italy and not many more besides Mr. Volcker. What have these five years wrought? Essentially two things:

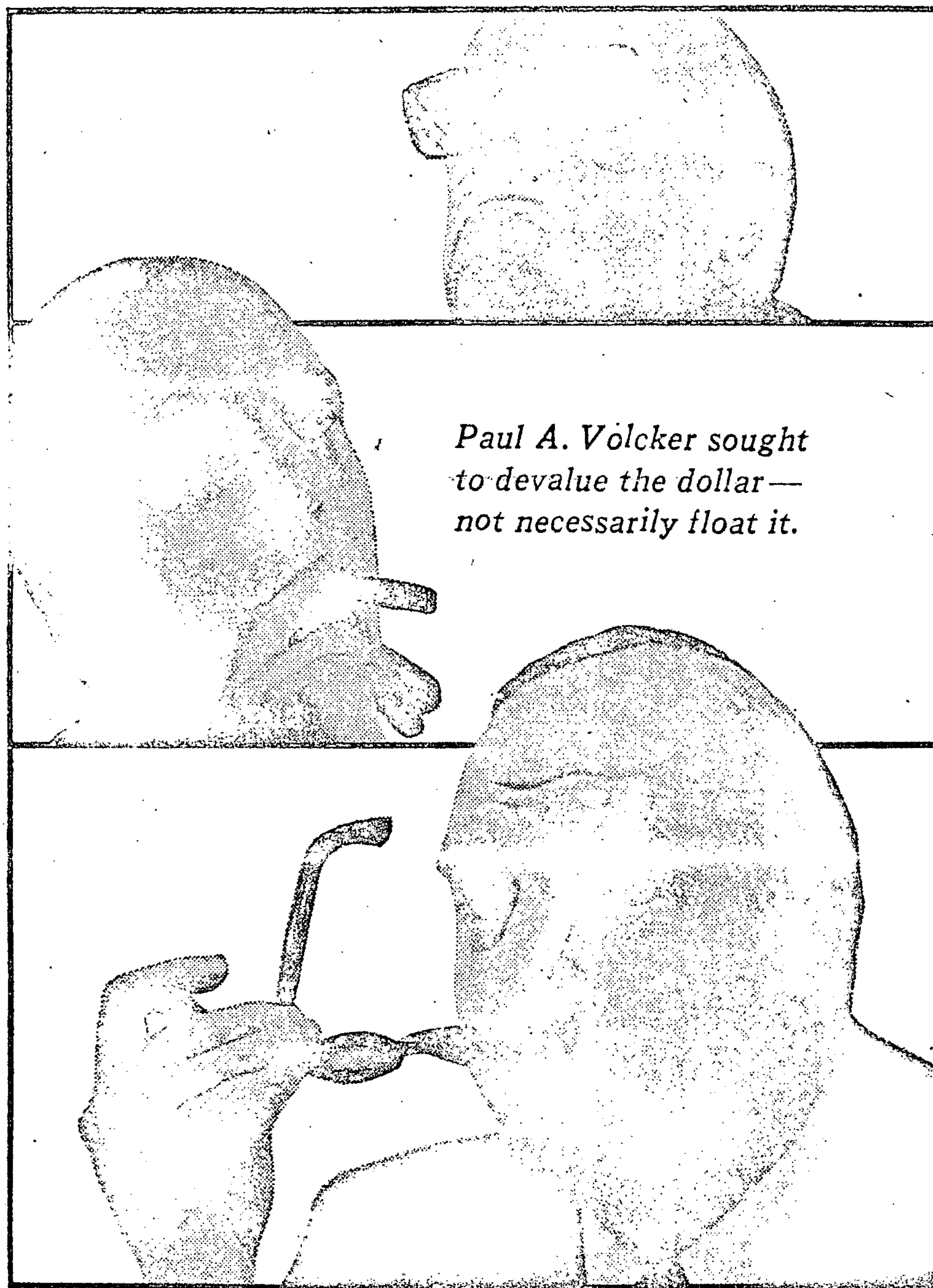
¶By the end of the period, the worst peacetime global inflation in modern history.

¶A profound transformation of the world monetary system from fixed to largely floating currency-exchange rates.

In the view of Mr. Emminger and some others, the second may be an essential element in the cure for the first. Or, put another way, according to this school the final death throes of the system of fixed exchange rates produced a massive and unintended extra inflationary thrust to the world.

This happened as countries such as Germany and Japan had to pump up their domestic money supplies as a counterpart to buying billions of United States dollars on the foreign-exchange markets to preserve the established exchange rates. This newly created money was an important factor in the inflationary boom that got under way in late 1972 all over the world.

But no one really foresaw all this in 1969. Mr. Volcker would not at that time have forecast floating exchange rates and probably not even a sharp depreciation of the dollar's exchange rate against



Paul A. Volcker sought to devalue the dollar— not necessarily float it.

nearly all the other leading currencies.

By now it is nearly unchallenged conventional wisdom that the dollar had become gradually overvalued starting some time in the nineteen-sixties. And, in the United States at least, it is also increasingly the conventional wisdom that a system of floating exchange rates is probably the best of all systems.

Before assessing the situation as it stands today, it is worth recalling that Mr. Volcker in no sense set out to create a floating exchange-rate system.

First under Treasury Secretary John B. Connally at the Smithsonian conference in December, 1971, and later in several European capitals in February, 1973, when George P. Shultz was Secretary, Mr. Volcker sought not to free exchange rates but to reestablish them on a more realistic basis. He sought to devalue the dollar, not to float it.

In both cases, market forces overwhelmed the new pattern of exchange rates. Mr. Shultz was ahead of Mr. Volcker and many others in coming out forthrightly for floating as the "least evil," which was finally done at the Paris conference of finance ministers in March of last year.

There is now universal recognition that floating will continue indefinitely—though not necessarily forever—partly because of the huge increase in world oil prices. This was reflected in the recent decision of the Committee of 20 nations negotiating world monetary reform to drop all further discussion of a return to fixed parities.

This can be said of the experiment in floating:

¶First, as Mr. Shultz frequently points out, floating has avoided monetary crises in the old sense—massive flows of dollars into one or more countries, foreign central banks being swamped, domestic money supplies exploding, exchange markets closing and emergency meetings of finance ministers. Flows of funds now cause changes in rates, not changes in monetary reserves (except ... cretion to intervene in the foreign-exchange markets).

¶Second, thanks ironically to inflation, floating has not so far tempted any country into a beggar-thy-neighbor policy. This is a major lesson just beginning to be perceived here.

If a government is worried about inflation, as all are, it is important to keep one's currency-exchange rate up not down, as used to be feared. Britain has been doing so. France, despite a small effective devaluation in January, has been doing so. Japan has let the yen rise in the last eight weeks, and Germany has let the mark rise.

If inflation should be replaced by serious recession and unemployment, this situation could change. For the time being, however, inflation has brought one blessing: no competitive depreciation of currencies and no trade restriction against imports. This point was emphasized last month in a speech here by Mr. Emminger. No one seems to have contradicted him.

Two problems associated with floating have been brought out by Arthur F. Burns, chairman of the Federal Reserve Board, who has had reservations from the outset.

¶One, floating can make any nation's inflation problem worse in a "vicious circle" fashion. If its price level is rising faster than the average, its exchange rate tends to depreciate, which in turn contributes to raising the price level even further.

¶Two, contrary to a widely held view, a nation may be less able than under a fixed-rate system to conduct an independent interest rate policy. If United States rates are lower than elsewhere, money will flow out and the dollar's exchange rate will depreciate, thus again making the domestic inflation problem worse.

And Dr. Burns told Congress this month of an additional problem, which is readily conceded by Mr. Shultz: "The magnification of exchange fluctuations through speculative trading is a troublesome feature of a floating system."

Mr. Volcker shares some of these reservations. But he departs in the knowledge that there is no real alternative to currency floating for the time being. He did not particularly want it, but neither he nor anyone else could preserve a fixed-rate system against the massive forces of the market.

And he did much to achieve the main American objective: a more realistic exchange rate for the dollar and hence a far healthier

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Analysis of Credit Markets' Role

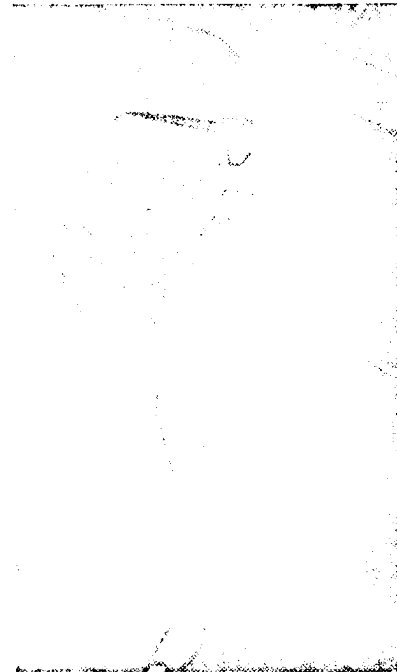
P. D-1 — Sept. 17, '76

By ANN CRITTENDEN
Special to The New York Times

ATLANTIC CITY, Sept. 16—A central banker gently took the nation's economics profession to task today for what he called its relative neglect of the role of the credit markets, and of financial complexities in general on economic activity.

Paul A. Volcker, president of the Federal Reserve Bank of New York, told a luncheon gathering of the American Economics Association and the American Finance Association in Atlantic City that the "relatively little attention directed toward serious and systematic analysis" of credit markets and their disruptive potential had contributed to a general failure to understand the implications of such phenomena as the Eurodollar market, the recent commercial bank loan losses and the shifting proportion of debt and equity.

In some respects his complaint echoed the sentiments of Alan Greenspan, chairman of the President's Council of Economic Advisers, who said recently that the trouble with most economic models was that they did not take adequate account of the financial markets.



The New York Times/John Sotomayor

Paul A. Volcker of the Federal Reserve Bank of New York, speaking in Atlantic City, N.J., yesterday.

In part this failure, according to Mr. Volcker, is a result of the intellectual triumph in the 1960's of monetarism, a theory emphasizing the effect of changes in the money supply on the level of economic activity. In policy terms, the theory implies that to keep the economy growing at a steady, noninflationary pace, the central bank simply has to set a moderate, fixed rate of expansion in bank reserves, and not worry about short-run fluctuations in other targets such as interest rates.

The problem with this approach, according to Mr. Volcker, is not only that the statistical association between the money supply and inflation is complex and "rather loose", but that the Fed has a very hard time controlling money at all, whether it manipulates bank reserves,

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tampers with interest rates or takes other action.

Doctrine Confronts Reality

Eventually, simple doctrine comes up against complex and harsh reality, he said.

Nevertheless, Mr. Volcker said that the Fed's practice of announcing each quarter its money supply targets for the coming year—a practice adopted more than a year ago under Congressional pressure and over the vigorous protests of the Federal Reserve's chairman, Arthur F. Burns—has proved a useful experiment in "practical monetarism."

In particular, the specifying of longer-range targets has forced the Federal Open Market Committee to justify more clearly in its own mind its short-term decisions to influence monetary aggregates, thereby reducing the tendency to overreact to a short-term and possibly temporary phenomenon.

A less sanguine view of the Fed's recent performance was taken earlier, during the morning sessions of the annual gathering of the Allied Social Sciences Association, a gathering of some 4,500 economists at an old seaside hotel in the Jersey resort.

John R. Bunting, the activist chairman and chief executive officer of the First Pennsylvania Bank and First Pennsylvania Corporation and avowed supporter of Jimmy Carter, told reporters that over the last year to accommodate a vigorous and balanced economic recovery.

"If you want to bring the economy back to a reasonably healthy state next year," Mr. Bunting declared, "interest rates should be around 6 percent by the end of this year." He added that with the current makeup of the Federal Reserve Board this will not happen and rates will remain stable around their current levels. The prime rate at most banks is now 7 percent. This means, he added, more stop-go economic activity and a foreshortened recovery.

"We're in the 1930's and we don't know it," Mr. Bunting added acerbically.

This year was the first in which political issues could be openly discussed at an A.E.A. meeting and the break with tradition was dramatized by a well-attended debate between Democratic advisers Charles A. Schultze and Lester Thurow on the one hand, and Herbert Stein and Marina Whitman, former members of President Nixon's Council of Economic Advisors, on the other.

For a brief period, statistics gave way to slogans and economic jargon to political jabs. Mr. Stein held that the major issue of the campaign was the "freedom of the individual to spend his own income and to manage his own economic affairs," something that could be jeopardized by a string of Democratic administrations and their propensity to increase the influence of Government over economic

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Approved For Release 2009/08/28 : CIA-RDP05S00620R000200480003-5

Sunday, September 24, 1972

N.Y. TIMES

Busy Peddler Of Monetary Reform Abroad

By EDWARD COWAN

WASHINGTON — One of the more sought-after people at the annual five-day clambake and jamboree of finance ministers and central bankers that opens here tomorrow will be Paul A. Volcker.

As Under Secretary of the Treasury for Monetary Affairs, Mr. Volcker will be outranked at the annual meetings of the International Monetary Fund and the International Bank for Reconstruction and Development by George P. Shultz, the new Treasury Secretary.

However, Mr. Shultz is a comparative neophyte when it comes to official-asset convertibility and other international monetary mysteries. Or, as an official of another agency put it, "Paul is in charge of strategy and tactics."

That remark may have been hyperbolic, but only a little. Mr. Volcker is known from London to Tokyo as the chief architect of and traveling salesman for United States international monetary policy.

Of late, there have been complaints that Mr. Volcker has been continent-hopping without his sample case. Since the realignment of exchange rates at the Smithsonian conference in Washington last December, the United States has said little about how to reform the international monetary system.

"I don't think the Americans know where they're going," an exasperated university economist said. "Paul's not exercising leadership. In the periods of system-building, he hasn't been the man to do it."

What Mr. Volcker and his opposite numbers from other industrial countries hope to devise is a new arrangement for smoothing out imbalances — surpluses and deficits — in the flows of money among countries for trade, investment and tourism.

The old system, based on dollars and gold, was interred on Aug. 15, 1971, when President Nixon slammed shut the Treasury's gold window. That paved the way for devaluation of the dollar and ended the post-World War II era of fixed exchange rates that were changed only rarely.

How to achieve greater exchange-rate flexibility while retaining some sort of fixity is one of the tasks of reform. Europe, which holds billions of dollars as a result of chronic United States payments deficits, wants to know what sort of convertibility Washington contemplates. If not into gold, then what?

Washington, which has no particular reason to foresee an early return to equilibrium, would like to wrest from Europe and Japan a commitment to revalue their currencies upward when in persistent surplus.

Some in Washington speculate that Mr. Volcker knows very well what he thinks about reform, but that he is playing his cards close to the vest, as he learned to do from former Secretary John B. Connally.

Everyone in Washington credits Mr. Volcker with having a keen mind and an inordinately fine grasp of financial and monetary issues. "He's capable of keeping a lot of complicated and subtle considerations in his mind all at once," said Marina Whitman, an economic adviser to the President.

Some also credit him with an appreciation of political realities. Mr. Volcker himself

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says that monetary issues are "more important to international harmony than to the domestic economy of the United States."

The Under Secretary displayed some of his widely reputed skill at give-and-take a few days ago at a Congressional hearing. Senator Jacob K. Javits, Republican of New York, asked when the United States would make its proposals.

"Well, I don't know what you mean exactly by proposals, Senator," Mr. Volcker began his reply. It was a cheeky stall.

The Senator bored in, his tone stern, asserting that Europeans had told him that Washington was not exercising leadership.

"Well, I've done a little traveling in Europe recently myself, Senator," Mr. Volcker shot back, adding that some Europeans had advised him against making proposals now.

Senator Javits backed off, apologized for his tone, and asked in a conciliatory way whether proposals were being prepared.

"We have made some, we will be making more, and we have a good many ideas in this area," Mr. Volcker said. End of skirmish.

Mr. Volcker obviously likes to spar intellectually. There have been complaints that he is disdainful of lesser experts, whom he skewers, as one Volcker watcher expressed it, "with a captious thrust."

●

"He's a tall man and he talks down, so to speak," said a policy adviser of more-than-average height.

Mr. Volcker, who must be very tired of being asked how tall he is, habitually has said 6 feet 7 inches, but he concedes he is taller. As for "talking down," Mr. Volcker acknowledges that when disagreements arise, "A lot of times you think it's because the other fellow doesn't understand."

According to some accounts, Europeans found Mr. Volcker abrasive in last year's tough months of bargaining on monetary and trade issues. (Another view is that Mr. Volcker was "the voice of moderation," the man who smoothed the feathers ruffled by Mr. Connally, who spearheaded the United States drive for trade

Mr. Volcker was asked about such criticisms during an 80-minute interview in his third-floor office at the south end of the Treasury, and he appeared to weigh them gravely. He recalled the tense atmosphere last autumn and the Administration's feeling that "we had to convince people that things had to be changed."

"After several years, I felt fairly comfortable with a lot of these people," he reflected. "Maybe you get sloppy. You're more to the point than you should be. It's easy to get sarcastic in making a point."

At 45 years of age, Mr. Volcker has lost most of his hair, which has whitened at the temples. The smooth head and a little jowliness make the boy-wonder days seem long ago. So do the long cigar and the deep, growly voice.

But the man still has a light-hearted, youthful, sense of humor. He fails to dissemble when a question touches a tender spot.

There is one other fundamental criticism of Mr. Volcker, and some of his best friends make it: that he is indecisive.

A member of the interagency "Volcker group" thought at first that the chairman's habit of asking questions was only truth-seeking, but later began to wonder whether he had a view of his own.

"He looks for reasons for not doing things," an academic economist said. "He rejects almost any simple or dramatic solution. Perhaps

subconsciously he welcomes delay."

"A not tremendously decisive sort, subject to self-doubt and uncertainty—like the rest of us," one colleague said.

What else is Paul Adolph Volcker?

He is a husband and the father of two teen-age children who is described as a devoted family man.

"He doesn't shortchange his family any more than all of us do in this kind of work," an associate said. He meant that Mr. Volcker, like a lot of important executive-branch people, works late most evenings and spends many weeks abroad, 12 in 1969.

Mr. Volcker wishes he had more time to garden, to produce something more tangible than a monetary system, which is really an abstraction.

The grapes he grew one summer in Montclair, N. J., produced wine that "came out like shellac." Maybe he'll become a serious grape grower and vintner one day, he muses.

He reads "whatever my wife has around the house," most recently "The Happy Hooker," the first pages of "the book about Stilwell and China" and a book about wine.

He likes to fish but he spends most of his time working. A few weeks ago he celebrated his birthday, while at a conference in Austria, singing in a pub with a couple of friends until a late hour — and that, evidently, was a rare bit of frivolity.

Born on Sept. 5, 1927, i Cape May, N. J., he grew u in Teaneck, N. J., an upper middle-class suburb not fa from the George Washingto Bridge where his late father for whom the son is named was City Manager for mor than 20 years.

From public high schoo Paul went to Princeton. Wha had he done there?

"Not much," he said wit calculated flippancy.

Had he not graduated sum ma cum laude and had no that required a lot o studying?

The question amused him He recalled that his fathe disturbed by Paul's casual ap proach to scholarship in hig school, had warned him tha in college he would have t work.

"I never found college ver hard either," he quipped. " was reasonably facile in wri ing and I could regurgitat what I was supposed to."

He went on to Harvard from which he graduate with an M.A. in economics i 1951. He was supposed t write his doctoral thesis dur ing a year on a Rotary fe lowship at the London Schoo of Economics.

"It seemed like a waste o time to write a thesis," he explained. "That's why I'm no a doctor." His voice wa laced with irony.

After finishing college Paul applied unsuccessfull for a job at the Treasury an the Federal Reserve Board Later, through the interven tion of a friend of his father he was interviewed by Rob ert V. Roosa, the young re

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search director at the Federal Reserve Bank of New York who was emerging as one of the monetary superstars.

Mr. Roosa, now a partner at Brown Brothers Harriman & Co., a Wall Street banking house, was impressed by Paul's keen interest in the central bank's dealings in the government securities market. Mr. Roosa found him to be ingenuously enthusiastic.

"He asked swell questions, but he was modest and humble, not in the manner of someone who expected to be chairman of the board in his first year," Mr. Roosa recalled.

After a stint in the research department, where his knack for writing led to his drafting the reserve bank's monthly summary of money-market conditions, Mr. Volcker was eased into the multibillion-dollar securities trading operation.

The big banks can make or lose a lot of money in the government securities market depending on how well they read the signals coming from the Federal Reserve trading desk. So they like to hire capable men away from the central bank. Thus, in 1957, after five years at the Fed, Mr. Volcker joined the Chase Manhattan Bank across the street.

Before long he was representing David Rockefeller, the Chase president, on the commission on money and credit, where he met some very senior men from the financial community and broadened his knowledge of financial issues.

When Mr. Roosa joined the Kennedy Administration as Under Secretary for Monetary Affairs in 1961, he brought Mr. Volcker to the Treasury and made him Deputy Under Secretary in 1963. Mr. Volcker learned in depth about managing the Federal debt, an important part of his present job, and about dealing with foreign finance ministers and central bankers.

In 1965, he returned to the Chase as vice president in charge of planning. Again he represented Mr. Rockefeller, by then a figure of great international reputation, this time on a blue-ribbon committee that advised the Johnson Administration.

His approach to monetary issue is gradualist and not doctrinaire. He may have flirted with floating exchange rates a while back, according to one source, but he now leans toward making announced rates more flexible.

As a young man, Mr. Volcker, whose famly was staunchly Republican, switched to being a Democrat. But those are only party labels, not essences. Mr. Volcker is essentially an Eastern money man, one of the New York banking crowd that has been shaping the United States's monetary policies since Alexander Hamilton.

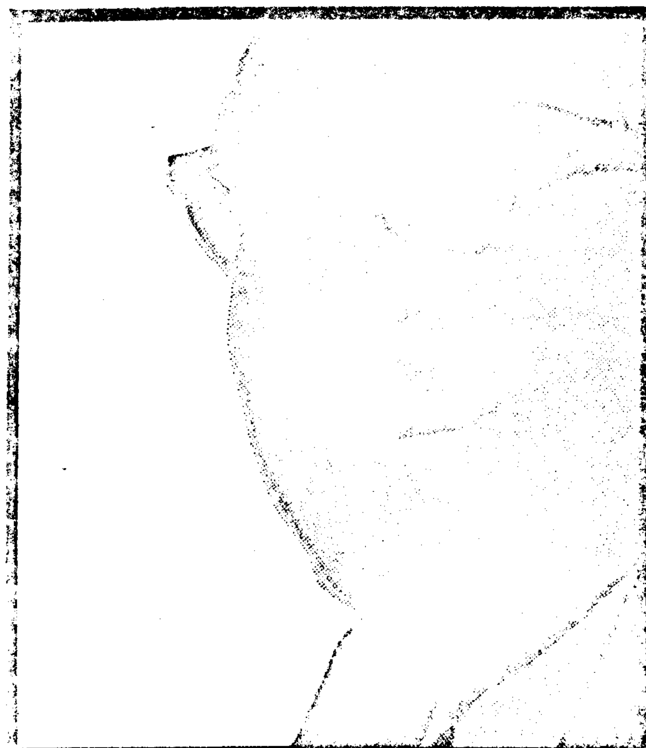
And so, in 1969, Mr. Volcker returned to the Treasury to be Under Secretary in a Republican Administration —a job that pays $40,000 a year. It is an obvious speculation that he might one day be chairman of the Federal Reserve Board.

That job might appeal to him more if it paid more than $42,500. Mr. Volcker has dipped into savings since returning to Washington.

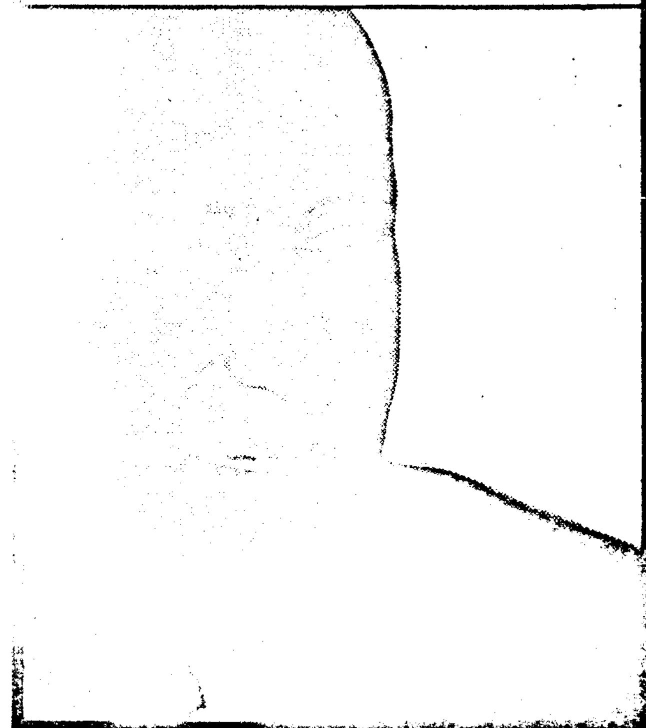
He has turned down the presidency of the Federal Reserve Banks of Minneapolis ($45,000) and San Francisco ($67,000). The trustees of the New York bank pay their president $90,000. The job has been held since 1956 by Alfred Hayes, who is 62 and whose present term expires in 1976.

What about the future?

There was a long silence as he sank deeper into the leather couch, puffed on the ever-present cigar, and stared at the gold drapes. "Oh, that worries me sometimes," he said. "I kind of like to be close to the action some place so I get stimulated. Otherwise it's too easy to be lazy."



Paul Volcker of course is not alone in his quest for monetary reform. Other nations have their salesmen traveling to Washington, Paris or London too, propounding their own ideas. Two of the most prominent are Rinaldo Ossola (above), exuberant theoretician and deputy governor of the Bank of Italy, and Otmar Emminger, cheerful pragmatist and deputy governor of the Bundesbank, West Germany's central bank.



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