The Economic Club of New York

293rd Meeting

The Honorable Jeane J. Kirkpatrick
United States Ambassador to the United Nations

The Honorable Paul A. Volcker
Chairman, Federal Reserve Bank

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Questioners: Albert V. Casey
Chairman, American Airlines

James D. Robinson, III
Chairman, American Express Co.

Introduction

Chairman Edmund T. Pratt, Jr.

Good evening ladies and gentlemen and welcome to the 293rd dinner meeting of the Economic Club of New York. As we say in show biz, it's a sellout, and well it might be in view of the critical nature of the responsibilities held by our two guest speakers this evening. Our guest speakers, of course, are Jeane J. Kirkpatrick, United States Permanent Representative to the United Nations, and Paul A. Volcker, Chairman of the Federal Reserve Board.

As questioners representing you, the audience, we are fortunate to have two outstanding business leaders who are also members of the Economic Club. These two questioners are Albert V. Casey, Chairman of American Airlines, and James D. Robinson, III, Chairman of American Express.

Our first speaker this evening, Ambassador Jeane J. Kirkpatrick, is President Reagan's Permanent Representative to the United Nations. With that post, she's also a member of the President's Cabinet and one of his key foreign policy advisors. Before accepting President Reagan's appointment to the UN, Ambassador Kirkpatrick taught in the Government Department at Georgetown University. Even then, however, she by no means limited herself to the campus. While at Georgetown, she was a Resident Scholar at the American Enterprise Institute for Public Policy Research.

In and around Washington, she was a leading participant in the foreign policy debates about the direction of the foreign affairs of the United States. It is no secret that this activity, including her writings for some of the more important intellectual policy journals in the country today, first brought her to the attention of candidate Reagan. Her articles in *Commentary Magazine*, on "Dictatorships and Double Standards" and "US Security and Latin America" are probably two of the most notable of these. But these important policy pieces were complements to earlier scholarly books and monographs. These include "Leader and Vanguard in Mass Society: A Study of Peronist Argentina" published in 1971, "Political Woman" published in 1974, and "The New Presidential Elite" published in 1976. She's also written extensively for *The New Republic*, *The Journal of Politics, The American Political Science Review*, and many others.

Beyond the intellectual world, Ambassador Kirkpatrick has been active advising political leaders and elected officials. By 1980, she was advising the Republican Party's presidential nominee on foreign policy. Given her party affiliation as a Democrat, the appointment as Permanent Representative to the UN is all the more a tribute to her talent and her intellect.

Ambassador Kirkpatrick has received many academic honors, including her PhD from Columbia University in their Political Science Department. This degree, I might add, did not come until some years after her undergraduate studies, a husband and three grown children afterwards to be exact. Ladies and gentlemen, please welcome a truly remarkable woman, the United States Permanent Representative to the United Nations, Jeane J. Kirkpatrick. (Applause)

Jeane J. Kirkpatrick

Permanent Representative to the United Nations

Thank you very much. I greatly appreciate the opportunity to address the Economic Club of New York and to share this platform with Paul Volcker, Chairman of the Federal Reserve Board. Mr. Volcker and I have different, but also interdependent, responsibilities. His job, as I understand it, is to defend the value of the dollar. I, among others in the new administration, must try to defend the values and indeed the aspirations of the American people. I doubt that I can do my job well if he doesn't succeed at his. But by the same token, if we who are responsible for the formulation and execution of American foreign policy do not succeed at our job, I doubt that he can succeed at his, or that it will count for much even if he does.

It is entirely conceivable after all that an affluent and technologically-advanced civilization may succumb to one that is distinctly inferior in wealth and well-being of its people. The decisive factor in the rise and fall of nations is what Machiavelli called virtu, meaning the vitality and capacity for collective action. In the battle today in which we are involved against systems which espouse and practice un-freedom, a free society has an enormous advantage of which we are all aware. But without the will not merely to survive but to prevail these advantages which we have will count for naught.

We have now entered a period when the moral and political will of our nation is, I think, and will be tested as never before. If I am hopeful that we can successfully meet this test, it is because of the new situation that exists as a result of Ronald Reagan's victory in the last election and the effective causes of that victory, and also because of certain changes that have taken place in the world that have created new opportunities for our country and its allies.

Still the challenges we must face are awesome and it is by no means a foregone conclusion that we shall prevail in the tests that lie ahead. The new period may be understood as the third period of the post-World War II era. The first of these periods spanned two decades and began with the Soviet takeover of Eastern Europe and the subsequent creation of NATO and ended at some point in the late 60s. Probably at that moment in early 1968 when the establishment that had guided American foreign policy in the post-World War II era turned against our involvement in Vietnam. This first period, for want of a better term, has been called the era of the Cold War. Some critics of American foreign policy look back with dread on the so-called dark years of the Cold War and express a morbid fear lest we reenter such a period.

I must say that I have some problem with this characterization and this fear. In the context of the 20th century, a century filled with horrors on a scale really literally unprecedented in human history, the years of the Cold War were a relatively happy respite during which free society was unusually secure. The West was united, self-assured, and strong. The United States and the democratic ethos we espoused were ascendant in the world if not everywhere triumphant. The circumstances in which we found ourselves during those years encouraged the expression of our national penchant for optimism, vision, and leadership. We were very strong and very prosperous. No country or group of countries could compete on equal terms with us economically or could successfully challenge our military power.

Moreover, all the major trends seemed hopeful. Our allies with our help recovered swiftly from the war and firmly established themselves as stable, prosperous, industrial democracies. In Africa and Asia, one country after another attained independence and looked forward to the prospect of democratic development in close cooperation with the West. And in the Soviet block itself, a series of political crises in Eastern Europe coupled with the ideological crisis brought on by Khrushchev's denunciation of Stalin's terror gave substance to the hope that Communism might indeed mellow if only we showed sufficient patience and fortitude.

While we felt under no delusion or compulsion to delude ourselves about the inherently antagonistic nature of Communism, we were confident that what we then called the Free World would ultimately prevail. These hopes, as we now remember, were destroyed by the protracted and bitterly disillusioning conflict in Vietnam and by a sequence of political, economic, and cultural shocks which polarized our society and shattered the confidence of our ruling political elites.

It is not necessary to review in full detail here the second period in the post-War era which began with the full emergence of the new left in the last 60s and ended with the defeat of Jimmy Carter and the victory of Ronald Reagan in the last election. We all remember that recent past, I think. I propose simply to recall a few major points. This period, which has euphemistically been called the era of detente, was marked by the relentless expansion of Soviet military and political power and by a corresponding contraction of American military and political power. It was marked as well by the rise in what came to be called the Third World of dictators spouting anti-American ideology and by the rise in Western Europe of tendencies favoring what some people consider to be a neutralist position in world affairs. Not least, this same period saw the emergence of OPEC as a major economic power whose monopoly pricing introduced inflationary shocks throughout the world economy, most disastrously in that same Third World, which countries were presumably linked by experience and ideology with the fraternal oil-producing states.

Within America, an attitude of defeatism, self-doubt, and self-delusion, an attitude that Solzhenitsyn called the spirit of Munich, displaced what had been a distinctly American optimism about the world and our prospects as a nation. For a time, the proponents of defeatism cultivated an air of their own superior optimism. We had, so it was said, liberated ourselves from the fear of Communism and were therefore free to identify with the forces of change that were sweeping the world.

The seizure of the hostages in Iran, the Soviet invasion of Afghanistan destroyed this attitude of determined equanimity as completely as the events of the late 1960s destroyed the hopes of the first post-War period. Viewed from this perspective, the election of Ronald Reagan was a victory for those who rejected the idea of the inevitability of America's decline. In this respect, the elections of 1980 constitute a watershed marking the end of a period of retreat. Similarly, the inauguration of President Ronald Reagan signaled a new beginning for America, an event endowed with particular symbolic significance by the simultaneous release of our hostages which closed the most humiliating episode in our history.

I might say sitting on the inaugural platform that day it seemed like the ending of a grade B movie – there was the inauguration of a new and graceful president, suddenly there was sun in the skies in Washington which had been gray and rainy for weeks, and within ten minutes of his taking the oath of office, the plane bearing the hostages had lifted off from Tehran. Who can doubt, moreover, that the most recent momentous event, the attempted assassination of the same president and his seemingly nearly miraculous recovery offers still another image of our fate. That of a country that has weathered a sea of troubles and has emerged from its trials with a buoyant spirit and undiminished moral and physical strength.

The new American consensus, which is reflected in the foreign policy of the Reagan administration, rests upon what *The Economist Magazine* last week called a general American conviction that the Soviet Union has now to be stopped. In the most urgent sense, this means that we are now prepared to spend for our military defense whatever is needed to ensure our national security and to restore a stable worldwide balance of power. One of the most extraordinary changes in the history of public opinion polling measurement of our national attitude has occurred, by the way, in the reversal of popular attitudes concerning defense spending.

Since I detect in some circles a misunderstanding of the Reagan administration's foreign policy, I hasten to add here that we in the administration do not think that all the problems we face in the world are military, or that they have a military solution. Secretary of State Alexander Haig has spoken of the importance of balance in our foreign policy, an idea that suggests the need to have policies that reflect an appreciation of complex issues.

As I understand the concept of balance, it means the ability to address at one and the same time potentially conflicting objectives in a way that strengthens the overall coherence and effectiveness of our policy. We are committed, for example, to restoring our military strength and to negotiating with the Soviet Union for the mutual reduction of nuclear and conventional weapons. A policy of balance in this instance would be based on the view that military strength is not an alternative to meaningful negotiation, but a pre-condition for it. If we are strong, we will have nothing to fear from negotiation because we will not be negotiating out of fear. By the same token, there is no more certain prescription for disaster than to negotiate from a position of weakness, and this we will not do.

To cite a second example, it is frequently said that an emphasis on national security precludes a concern with human rights, particularly with human rights in authoritarian states that are friendly to the West. But surely we, in the United States, in this administration will have more credibility with such governments and we will have more influence with such governments and their human rights practices if they understand that we respect their national identity and autonomy and that we understand the problems confronting them as they attempt to establish their own security which we will have linked in some fashion also to our own. Then, and only then, we believe will it be possible to construct a human rights policy which will leave real people somewhat more free, somewhat more secure, somewhat more certain of enjoying due process than they were before.

To cite a final example, it is believed that it is impossible to pursue a policy in Africa that is both aimed at containing Soviet expansion in that continent and also anti-racist. Yet we believe that only a policy that actively works toward both these ends simultaneously has any chance of succeeding. If nothing is done to contain the Soviet threat in Africa, the inclination in Pretoria will be to batten down the hatches and prepare for a long siege. If the Soviet threat is contained, the prospects for peaceful change in Southern Africa and our ability to influence that process are alike greatly enhanced.

The ability of the Reagan administration to deter and discourage Soviet expansion and to reverse the decline of American power is greater now than during the preceding period despite the unfavorable military trends because of a global development that parallels in a very interesting and significant fashion the sea change that has taken place within the United State itself. I refer to the exhaustion of Communist ideology and of ideological radicalism generally. This development that marks the end of the period of radical ascendancy that began with the emergence of the new left as a worldwide movement in the 1960s has now, I think, reached a high and accelerating trend.

It has been many years now since the Soviet model of Communism appealed to any significant segment of opinion in the world – either inside or outside the Soviet empire. And now even Maoism which had displaced Stalinism in the ideological vanguard of communism has been rejected by none other than the Chinese leaders themselves – a development of far-reaching importance in Asia and Africa where Maoism once had great appeal.

But of all the recent developments, none is more significant than the events in Poland. The emergence there of an autonomous worker's movement, a genuinely autonomous worker's movement which is the only such movement of its kind in the world implicitly, if not explicitly, challenges the legitimacy of so-called Proletarian Communism that cannot be...by reasserting the strength and power of the idea of freedom in an authentic working class. Here we have the ultimate confirmation of Jean Francois Revel's observation that Communism is oppressive in its domination and liberating in its propaganda.

The internal crisis of Communism comes at a time when the cumulative impact of Soviet expansion which can be seen in the proliferation of refugees fleeing Soviet-sponsored war, terrorism, repression, and economic devastation has introduced new issues into the world political agenda – new issues that offer obvious advantages to American diplomacy. The new political environment is also an outgrowth of deepening political, economic, and military conflict within what is still so inappropriately called the Third World.

These conflicts, along with the widespread and growing disillusionment with state Socialism as an economic system, should lead a growing number of nations to look to the United States as a source of stability in world affairs and a model of progress. Fortunately, the readiness of others to take a fresh look at the American experience coincides with a domestic renewal of belief in the value of freedom. This belief is exemplified by the new administration's determination to speak to the world with a clear and confident voice and to operate from the perspective that reflects the legitimate aspirations of the American people.

It is evident also in the new appreciation of freedom as the engine of economic dynamism and as the source of our national strength. The renewal of pride and belief in the values of our free society is not, as some have said, a sign that America is turning inward or becoming isolationist. On the contrary, the new administration embodies the belief that our own freedom is organically tied to the freedom of others.

The workers in Poland, the Freedom Fighters in Afghanistan, the Plantados in Cuba, the boat people of Indochina, the dissidents in the Soviet Union, and many others who are resisting totalitarianism are the true heroes of our time. If the spirit of freedom is rising in the world, and I think that it is, it is in no small measure due to the indomitable courage of these persons who are indomitably determined to be free. We cannot abandon them any more than we can surrender our own freedom to forces of despotism. This, we, in the Reagan administration, are determined not to do.

As a result, we now have an opportunity to strengthen the culture of freedom in this country and throughout the world. It is an opportunity, indeed I believe a historic responsibility, which the administration of Ronald Reagan gladly accepts. Thank you. (Applause)

Chairman Edmund T. Pratt, Jr.: Thank you so much Ambassador Kirkpatrick. We'll be looking forward to hearing more from you in the question period. Our second speaker this evening is Paul A. Volcker, Chairman of the Federal Reserve Board. Chairman Volcker, one of our country's preeminent economists, has had an outstanding career in public service and private enterprise.

He received his education from Harvard and the London School of Economics. His career has been intertwined with the Federal Reserve Bank System right from the beginning. He first was a summer employee at the New York Fed while in graduate school at Harvard. Next, he returned to New York after graduate school to begin his career as a full-time economist with the Federal Reserve Bank of New York. In 1975, Mr. Volcker became President and Chief Executive Officer of the Federal Reserve Bank of New York and continued there until he assumed his present position on August, the 6th, 1979.

In between the New York Fed and the Federal Reserve Bank, Paul Volcker worked for the Chase Manhattan Bank as a financial economist where in 1965 he became Vice President. He held that position until 1969 when he was appointed by President Nixon to the post of Under-Secretary of the Treasury for Monetary Affairs. Paul remained Under-Secretary until 1974. During this time many of us will remember Paul as the principal United States negotiator in the development and installation of an international monetary system to replace the Bretton Woods arrangements. Ladies and gentlemen, please welcome Paul Volcker, the Chairman of the Federal Reserve Bank of the United States. (Applause)

The Honorable Paul A. Volcker

Chairman, Federal Reserve Bank

Thank you. Thank you very much Mr. Chairman. Mrs. Kirkpatrick and I appreciate the reciprocity of our responsibilities. Distinguished guests, fellow New Yorkers, five years ago when I last addressed the Economic Club, the preoccupation of the day was the acute financial distress of this great city and state. That big black headline in the *Daily News*, “Ford to New York – Drop Dead,” was not quite accurate. But in its bold and brazen way, it did carry a message. Any lasting solution to our economic problems would have to begin and end at home.

Now a month or so ago, I was struck by another headline, this time in the *Wall Street Journal* – an editorial entitled, " The Supply Side Saves New York." Somehow in five years, New York had become an example for the rest of the country to follow. Now from pariah to model city, from *Daily News* despair to *Wall Street Journal* praise, obviously overstates the contrast. But there does seem to be more than a grain of truth in the proposition that the New York experience is lessons for economic policy more generally.

In the nation as in the city, post-war decades of growth and prosperity nurtured a sense of almost unlimited resources and potential. We turned en masse toward completing a huge social agenda, achieving greater equity, cleaning our air and water, enhancing our health and safety, and ameliorating the risks of economic life. And certainly there's been progress towards those objectives. But those same efforts spawned a mass of regulations, new costs for industry, and a rapid rise in government spending. Effective tax rates gradually rose, helping to push up costs and prices and blunting incentives as inflation pulled people into higher tax brackets.

But in spite of higher taxes, deficit spending became the norm. Inflationary forces and expectations became ingrained in fact and in our thinking, propelled in part by the energy crisis and other external factors, but also partly accommodated by financial policies. There's been a growing sense that with productivity declining, with money in capital markets under growing strain, and with inflation disrupting orderly planning, the base of our prosperity was being eroded.

Relatively high levels of unemployment and slow growth have been visible symptoms of the malaise. Yet it was hard to break out of the policy approaches and attitudes that underlay our problems. I was struck in that connection by a recent Peanuts cartoon that I happen to come across. I don't know whether any of you have recalled seeing it, but Lucy was standing behind the little booth labeled Psychiatric Advice, 10 cents. And consulting with Charlie Brown, somehow they got on the topic of cruise ships. And Lucy said, you know, there are two kinds of people on cruise ships, Charlie. There are those who take the deck chair and face it backwards because they want to see where they've been, and there are those that take their deck chair and face it forward because they want to see where they're going. Now, said Lucy, on that great cruise ship of life, Charlie Brown, which way will your deck chair be facing? And Charlie Brown said, I can't get it unfolded. (Laughter and Applause)

Well, somehow we've had a little trouble getting economic policy unfolded. But, you know, now under the pressure of events and in the new political setting, a fresh opportunity does present itself, a new lead, a new way of approaching our economic problems. The whole tenor of economic debate has been transformed and a new consensus seems to be emerging.

It's almost taken for granted that budgetary cuts, huge by past standards, are not only appropriate but attainable. Not only do tax cuts have a high priority, but discussions of tax reductions focus largely on what's best for incentives and investment. There is recognition of the need to cut back in the maze of regulation and protectionist elements in our economic policy. And not least, it's widely accepted that the growth of money and credit must be restrained persistently and consistently even when in the short run that may seem to aggravate pressures on interest rates and financial markets. Indeed I believe there's growing understanding that over time prospects for dealing with inflation and encouraging lower interest rates fundamentally depend on reducing monetary growth.

Now not so long ago, every one of those propositions would have been vigorously challenged either in terms of economic rationale or political feasibility. But let's have no illusions, the consensus that seems to be emerging about what can and should be done is a considerable way from embodied in law and policy. Much depends on how the new approaches are applied and time will need to pass before we can see the full effects. Hard choices will need to be made.

The proposed reductions in spending is a case in point. I can't help but be encouraged by the first congressional responses to the president's program. The chances of bending down the upward trend in spending appears greater than at any time in memory. But let's not forget the administration's proposals for fiscal 1982, dramatic as they are in an historical sense, are not the full measure of what the president himself feels necessary in a longer time frame. And if the first budget cuts are difficult, subsequent cuts, particularly as they must bear on a relatively small fraction of the total budget, will be even harder.

Yet, as in New York City, it's spending restraint that makes the tax reduction that we need prudently feasible. That's why the budgetary program seems to me the linchpin of the new economic program. It's also why from the standpoint of general economic policy; it seems to me all the risks are on the side of cutting spending too little.

I know how difficult changing the expenditure trend can be given the commitments to a social safety net and the requirements for defense and, of course, interest on the national debt. The search for savings must be broad. It will have to include programs that have been supported by the business community and to my mind also reexamination of the rationale and practical operation of the indexing now built into so many government programs.

Five years ago, New York City and state, with the financial markets closed or closing to them, could not escape the compelling need to cut back spending while stabilizing or reducing taxes. For the United States as a whole, the situation may appear less stark. Treasury securities, it can be argued, will in the last analysis always be purchased by somebody. And a sovereign nation can theoretically resort to the printing press to pay its bills. But neither circumstance provides a reasonable escape from the need to reduce the deficit. Money and credit growth needs to be reduced, not increased, over time. In those circumstances, we cannot expect to finance both large continuing deficits and the investment in modernization and expansion needed to support economic growth, to say nothing of housing and other sectors of the economy particularly dependent on credit.

To the extent savings are increased, the potential squeeze in the credit markets can be alleviated. The potential for increased savings in the United States should be large. After all, our personal savings rate has declined a little more than 4% of personal income, two-thirds or less of the amounts that not many years ago were considered normal. The poor performance reflects to some degree the way we tax savings and investment, a matter that is addressed by the administration's program, but it also reflects other and pervasive factors. Consumption has been maintained at high levels relative to income partly because the average worker has attempted to maintain consumption as his real income has declined, and partly because expectations of inflation have encouraged the buy now psychology.

Viewed in that light, discussions about whether those dollars received directly from tax reduction may be saved may miss the major point. What's more relevant for savings is what's happening to the economy as a whole and particularly whether there's confidence in prospects for restoring greater price stability and economic growth. In other words, success in reaching the objectives of the whole program will depend upon all the parts, not on tax reduction alone.

Uncertainties about the near term cost of inflation in the economy will inevitably have a large bearing on the actual budgetary outcome next year. Differences in assumptions on inflation, interest rates, and employment affect both revenues and expenditures. In recent years, those influences have almost always been in the direction of deficits larger than planned. Prudent caution on that score can only reinforce the need for spending restraint.

Now we have ample evidence that our ability to foresee the economic outlook over the next few quarters, much less a year or two, is limited. The corollary is that the days are gone when we could, with undue pride in our forecasting ability, fine-tune the economy. By the same token, the success or failure of the new directions for economic policy cannot reasonably be measured by what happens this year or next. What is essential is that the broad outlines of policy be set right and that it has time to work its effect.

Now I've emphasized the need for slowing the growth in expenditures, for moving towards smaller deficits. In that process we have to recognize that balance isn't at all likely to be achieved in a sluggish economy. What is critical is that spending and tax rates need to be set on a path that will, with a much greater degree of assurance than in the past produce balance and surplus as economic activity returns to reasonably satisfactory levels of performance. That's a feasible, practical goal, yet it's one that we didn't meet once in the decades of the 1970s. It's a goal that seems to me an essential complement of restrained monetary policies.

For most of the post-war period, I think you could characterize monetary policy more or less fairly as leaning against the wind in a kind of cyclical sense – encouraging restraint at high levels of business activity and expansion during periods of under-utilized resources. I doubt that traditional description is useful today.

The wind with which we must now be concerned is inflation. And it's been coming at us with a gale force from the same direction for years. In the current environment our objective is to avoid accommodating the inflationary process through the creation of money and credit. Or to put the point more positively, our aim is to encourage restoration of price stability by reducing growth in money and credit over time to amounts consistent with economic growth. Ultimately that approach provides a valid basis, and in the long run the only valid basis for anticipating lower and more stable interest rates. But in the short run, the situation could be quite different.

With inflation so strong and expectations so volatile, the significance of a particular level of interest rates or changes in interest rates is hard to judge. Our emphasis has turned to quantitative guides, reducing the growth in money and credit. That control is not precise in the short run. And in a dynamic changing economy, we should not expect stability and all the various money and credit measures from month to month or quarter to quarter.

There was, for instance, a burst of growth last fall in money and credit as the economy and credit demands recovered strongly from the recession. But the data for recent months suggest that various aggregates taken as a whole are again reasonably in line with longer run objectives. The basic thrust of our policy toward lower rates of increase over time should not be in doubt. If other forces are pulling in an inflationary direction, if the federal government is generating excessive deficits, if savings remain low, then the implication of restrained credit growth can indeed be congestion and pressures in credit markets.

In circumstances like that, restrain of monetary growth is a defense, indeed the ultimate defense against inflation accelerating. At other times, with economic activity and demand for credit softening, pressures on the market can subside. But neither of those situations are satisfactory reflecting as they do the strength of inflationary forces or sluggish business activity. However, attempts to stabilize interest rates at the expense of losing control of the growth of money will not provide a solution. Rather, lower and more stable interest rates will persist only when there's confidence that inflation is decelerating, and that confidence in turn is dependent upon avoiding excessive growth in money. But it's also clear that the process of restoring price stability will proceed faster and more smoothly to the extent other policies, public and private, are moving in a consistent direction.

In that connection, it's crucially important that market signals and market incentives work in the direction of improving efficiency and productivity and containing costs and prices. Too often regulatory practices and policies have blunted or undermined those incentives. Different approaches in that area are a matter of urgency. Fortunately, there are already signs of change. We can build on the example of airline regulation.

We have at least begun to approach the job of applying cost benefit analyses to our new social regulations. But I suspect the most important regulations are those we seldom think of in the context of regulatory reform and where the prospects for change may be more difficult. I'm thinking of all those policies that provide protection to individuals and businesses from competition and from the inevitable risks of economic life, even when those risks are in major part of their own making.

The active debate about restrain on Japanese automobile imports is an apt case in point. There are to be sure a number of conflicting considerations. There always are. Our car industry is in a difficult period of transition and the industry can point to governmental actions that have raised costs and impaired efficiency. But in the end, one is forced to ask whether over time jobs will be saved or lost in the American economy as a whole and whether our economy will work better or worse if we seem to be retreating from a basic policy of open international markets.

We're not dealing, after all, with an infant industry or exploited labor. Wages in the auto industry have been steadily rising faster than the US average and now stand 60 to 70% above that average. The right question to ask is surely whether the government, industry, and labor are doing all they can to reduce cost and to provide incentives to speed the return to quality and model performance that consumers demand.

If we sometimes look longingly at the organized nationwide annual wage bargaining, concentrated at a particular time of the year characteristic of Japan and Germany, we have to face the fact we don't have a comparable framework for reaching that kind of national consensus about appropriate non-inflationary wage settlements. But I suspect there's a more important reason for their relative success. Restraint in pricing and at the bargaining table reflects a conviction that restraint will pay off – pay off in larger markets, more jobs, and general price stability. That conviction can only grow out of experience, out of a sense that prices will in fact be relatively stable, that policies of restraint will be carried through, that something will be lost by inflated prices and wages.

It's that sense of conviction that we, as a country, have lost, but which we are capable of restoring. That seems to me the logic and the potential of the new winds blowing in Washington. And it is in that larger sense that the experience of New York must be heartening. Restraint, restraint in wages and costs, in budgets and in taxes does seem to be paying off here – paying off in a better regional competitive position and a reversal of the ominous loss of jobs in the early 1970s and in greater resistance to recession.

You know New York never had access to a printing press or to devaluation to solve its problem. That was fortunate. It's an illusion to think that lasting solutions can be found in a debased currency. On a national scale, that's the lesson of the past decade and more. That's why I see no alternative to our efforts in the Federal Reserve to scale back the excessive growth in money and credit. It's not a painless process. Nor is it comfortable to permit competition to work in the economy or to maintain the budget discipline that the times require. But out of these processes, sustained over time, can come a new sense of conviction and new patterns of behavior that will in fact restore both our pride and our progress. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN EDMUND T. PRATT, JR.: Thank you Mr. Chairman. And now we come to the question period of the evening. I will remind you we have two questioners who will alternate their questions, asking them of either one of the speakers, until we run out of questions or run out of time. If the speakers would please just rise and answer the questions that are addressed to them. Naturally, as first in the alphabet, Al Casey, why don't you go first.

ALBERT V. CASEY: Thank you Mr. Chairman. I'm going to address my first one to Madam Ambassador. Madam Ambassador, you said tonight that the administration will be speaking with a clear and confident voice. We want to believe this. In fact, we do believe it. But we are well aware that many ultra-conservative supporters of President Reagan at the time of the election were highly critical of the UN and any expansion of our role in it. Is it the administration's position that we should continue to be fully supportive of the UN, both from the standpoint of dollar support and taking leadership positions?

THE HONORABLE JEANE J. KIRKPATRICK: I think that it is the administration's position that we should begin as fully supportive of the United Nations, and that, by the way, that position is reflected in the administration's recommendations concerning the United Nations' budget on which, by the way, I will be testifying tomorrow morning before the Senate. We are proposing to continue at very nearly the contemporary rates without any reductions in fact. The United States' financial support, both for the United Nations as a whole in our assessed contributions but also for the voluntary agencies of the United Nations. Now we also expect, however, to be working hard to make the United Nations' agenda reflect a bit more fully some of the priorities and values of the American people. I spoke earlier about the legitimate aspirations of the American people. We'd like the United Nations' agenda to take account of those legitimate aspirations of the American people. We will be working hard to try to turn around policies of which we disapprove and, sure, we're in it to stay.

JAMES D. ROBINSON, III: Ambassador Kirkpatrick, speaking of budgets, one of the first victims of budget cutting has been foreign aid. Do you think these cuts will be disruptive to our overall foreign policy and specifically where?

THE HONORABLE JEANE J. KIRKPATRICK: Well, you know, I think in fact there is a popular misunderstanding about the administration's proposals concerning our foreign aid budget. We have not, in fact, proposed substantial reductions in our foreign aid budget. What we have done, as compared to the Carter budget, was to slow the rate of growth in those foreign aid budgets. We have thought, of course, that it was important to share the hardship, if you will, involved in our budget cuts generally. We have thought it would not be reasonable to ask the domestic budget to bear all the burden of our budget cuts. On the other hand, we have been very sensitive, those of us in the foreign policy domain, specializing in the foreign policy domain in the administration – I speak of Secretary Haig obviously and Secretary Weinberger and Richard

Allen and myself, the vice president, the president – we've all been concerned to make our foreign aid investments, if you will, sufficiently large that they will serve to promote the broader interests and the long-range interests of American foreign policy and our worldwide strategies. We have not assumed that foreign aid was not an important component of our foreign policy instruments. Quite the contrary, we have assumed the foreign aid was a useful and important tool of our foreign policy, a legitimate if you will, for one of those legitimate aspirations of the American people which is reflected in our continuing humanitarian concerns, and we propose to support it.

ALBERT V. CASEY: I ask Chairman Volcker, and I apologize for the early confusion, Paul, tonight you spoke of your support for reduced federal spending – in fact, you referred to it as the linchpin – and reduction in income taxes. But surely a critical part of the president's program is to channel greater investment into capital programs which will lead to increased productivity and thus more jobs. What fiscal programs do you propose to bring this one about?

THE HONORABLE PAUL A. VOLCKER: Well, I don't have an alternative blueprint. That's not my job. (Laughter) But I think you've – I might not have my present job very long if I assume too many others – but I think there is a consensus on the need for stimulating the savings and investment process as you suggest. And I take it, and I have no problem with this – it's always a matter of degree – that depreciation reform is perhaps the favored approach of many in the business community. And, of course, that is the approach that the administration has adopted.

Now you can argue, you know, in a full scale program over some years, there could be some depreciation reform. There could be some investment credit. There could be a lower corporate tax rate. There are various ways of going about this. And I think that's a legitimate area for debate in the Congress. But I think this program; of course, that they propose is a little bit misleading if you just look at the first year because it's phased in. It is a very big business tax reduction when fully phased in. It's something like half of all corporate taxes would be offset.

JAMES D. ROBINSON, III: Chairman Volcker, how about giving us your views on the effects of the projected deficits on inflationary expectation and interest rates?

THE HONORABLE PAUL A. VOLCKER: Well, the answer I would give and repeat is the smaller, the better. I think it is a central issue from our standpoint. Having said that, and you know there's a debate going on as to just what the deficit will be next year, largely – if not entirely – because the economic assumptions differ. And one of the difficult things, we have a lot of comparable problems I suppose in monetary policy, but from the standpoint of an administration, presenting a fiscal program and having to make certain assumptions about the economy and those assumptions translated into a particular deficit or hopefully someday a surplus, then you find the assumptions are off and the credibility is kind of undercut by a change in what was projected. I think all you can do is ask whether the projections are reasonable in the first place. Understand that if the pattern of the deficit is off course simply because the economy is moving in a different direction, that, that is not fatal to disciplined budgetary policies so long as the balance between taxes and revenues can reasonably be said to come into balance as soon as some attainable level of economic activity is reached. Now if you say an attainable level of economic activity is 4% unemployment in the near term, you're kidding everybody. So that's not reasonable. And if you take a level of unemployment of the kind we've actually attained in recent years, in the 6 - 6 ½% area, I think that is a reasonable time to look toward a surplus in the budget. Now it's taken me so long to explain that, you can see the political problem that you can sit out there and say what should the deficit be next year, and so may be the first answer, the smaller, the better, is the one to stop with.

JAMES D. ROBINSON, III: You unfolded your deck chair very nicely.

ALBERT V. CASEY: Chairman Volcker, while you're still on your feet, in today's *Journal of Commerce*, it was reported that Mr. DeRosa of Citibank questioned whether you reacted to the below-target money supply in February by acting unilaterally in deciding on a lower funds rate and the Open Market Committee commandeered your order. Would you care to comment on that? (Laughter)

THE HONORABLE PAUL A. VOLCKER: We're going from the sublime to the ridiculous. I'm sometimes amused or bemused by reading the paper, and I was quite bemused upon reading a number of articles this morning that I think confused basically what we're trying to do as a matter of operating technique. And it gets a little bit technical but it may be worth repeating. We are not trying to guide the federal funds rate from day to day or week to week. We do try to keep on a Reserve path that we think is consistent with the kind of monetary growth we like to see. Now where the confusion enters in is that it's quite true that the Committee in making its decisions each month or when it meets cites a range for the federal funds rate which is quite a wide range, usually kind of symmetrical around where it then is. And that serves a particular purpose. (Laughter) It's a kind of checkpoint. People say, look, if things have moved that far, let's consult and see whether we need to revise the Reserve paths or whatever. And we've done that on a number of occasions. What is interesting, to my memory offhand anyway, every time that's been done, that checkpoint of the federal funds rate has been violated, so to speak. They have not been taken as a constraint on our operations. That was not true by Committee decision and not the Chairman's decision when we consulted a month or two ago. I confess, I might not have been thinking as alertly as I might have been in retrospect. Usually when we do that, we change that checkpoint. This time we didn't bother and I naively thought that since it was obvious we were going through it, people would realize that it didn't control the operations. Instead, at least one person concluded that I went out of bounds I guess. But I think you've got to keep reminding yourself that our objective is not to guide that federal funds rate in the short run and rather a wide movement might be the occasion for reconsidering, usually in a rather technical sense, what policies seem appropriate in terms of the Reserve path to achieve the money supply goals we're interested in.

JAMES D. ROBINSON, III: A question for the ambassador please. In determining appropriate

US policy regarding foreign governments that are deemed, at least by some, to be repressive, you've introduced the concept of the lesser of the evils. Would you please explain your views?

THE HONORABLE JEANE J. KIRKPATRICK: Certainly. I think you've explained my views by introducing the concept of the lesser evils. I think in politics and policy as in life one is frequently confronted with choices that involve not greater goods but lesser evils. And in political science we deal with that notion in the classification of regimes quite regularly. What I intended to suggest by the distinction between the traditional autocracies which I said were relatively less repressive frequently and revolutionary autocracies which I said were relatively more repressive, was the kind of distinction that one finds in real life, if you will, between let's say the regime of Kaiser Wilhelm – he was an autocrat, he certainly wasn't an elected leader – and the regime of Adolph Hitler. Now there isn't much doubt about which one of those regimes was harder for the German people to bear, which was more devastating, which created more refugees, which was more dangerous for the world. Neither, I think, is it very difficult to distinguish in terms of human misery and impact between the regime of Lon Nol who was an undoubted autocrat, a dictator if you will, in Cambodia, and that of Pol Pot who wrecked absolutely incredible devastation on his people. I am not for any kind of autocracy. The only form of government which I support now or ever have supported is democratic government in fact. Most governments in the world, unfortunately for us, and most especially for the people who live under them, are not democracies. And we are frequently, in foreign policy, confronted with making policy for non-democratic governments. And I would say finally that to distinguish between measles and meningitis, to say that measles is less frequently fatal than meningitis does not mean that you're pro measles. (Applause)

ALBERT V. CASEY: Chairman Volcker, I would just, I believe that the economic burden of public service is excessively abusive to the individual, and we should like to know what you are doing about it. Also, can you attract and keep the quality of people we need and deserve?

THE HONORABLE PAUL A. VOLCKER: Well, I think you point to a real problem. Forget the politicians and the political appointments. There is no question we are having a problem potentially approaching a kind of crisis point in keeping staff potentially within the Federal Reserve and it can't be – we're particularly proud of our staff and our career staff – but it can't be much different in the rest of the government when you have the kind of compaction and ceiling that exists now in the career service. You ask people who, in the particular area in which they work, in the Federal Reserve, can for better or worse, command very much higher salaries or income in the private sector so they can go explain all those wiggles in the money supply and all the rest, and ask them to put children through college – that's the crucial age when they get to be in their 40s and have two or three or even one child going to college – you have a very serious problem. And it doesn't do anybody good to let these salaries get way out of line and then at some point have to have a great catch-up. At that point, you've lost your best people. And the people benefitting from the catch-up in some cases may be those who shouldn't be in the top jobs in the first place. So I do think that it is a kind of corrosive problem that erodes at the foundations of effective government unless it's dealt with. Now having said all that, this is a problem that's arisen over a period of years and I can well understand a president or even a Federal Reserve encouraging great reductions in government spending, finding it a little difficult to correct it in one jump at the moment. But it is a problem that should be, I think, very much in the forefronts of the minds of anybody who is interested an effective civil service in Washington. (Applause)

JAMES D. ROBINSON, III: Chairman Volcker, historically high and volatile interest rates have seriously impacted the thrift industry. What is the Fed's responsibility to the thrifts and what can the Fed do alleviate the situation?

THE HONORABLE PAUL A. VOLCKER: Well, what the Federal Reserve must do to alleviate the situation in the most fundamental sense I think is stick with it because those institutions are not going to have a future in an inflating economy. And that's what the basic trouble has been, that the inflationary process has brought quite different conditions in financial markets than those institutions were used to or could handle in any short period of time. So I don't think there's any escape from the problem, so to speak, in a change in monetary policy per se. Indeed, from the standpoint of those institutions, the more strongly we press, I think the better. Now institutions do have serious earnings problems and increasingly earnings problems in some cases. I think the normal apparatus of the government, including in this case the Federal Reserve where there is the possibility, indeed the responsibility, to lend to these institutions in whatever volume is required, should liquidity problems arise, it's there, it's in place. It is a highly effective means of handling that kind of a problem. I think there are other measures which are under some consideration in Washington to make sure that the normal powers of the FDIC or the FSLIC to inject capital in institutions when necessary will be ample to meet any immediate situation that could arise.

CHAIRMAN EDMUND T. PRATT, JR.: Gentlemen, would you each pick your best closing question and let's have one more from each of you please.

ALBERT V. CASEY: I'd like to talk to Madam Ambassador, if I might. I hope my facts are correct. If they're not, I'd like to have them corrected. The US continues to maintain its embargo on grain shipments to Russia. However, I cannot find that it objected to France's resumption of grain shipments to Russia. Why is this?

THE HONORABLE JEANE J. KIRKPATRICK: You cannot find what? I'm sorry.

ALBERT V. CASEY: That the United States government objected to France resuming grain shipments to Russia, yet France is our ally. We took no exception nor did we ask them to continue to restrain.

THE HONORABLE JEANE J. KIRKPATRICK: I don't think that's correct. I think, you know, we do quite a bit of talking in this administration about quiet diplomacy. And one of the reasons we talk about quiet diplomacy sometimes instead of talking about our policies, about what we're saying to other people is because we think perhaps that we can, in the long run, be more effective by quiet diplomacy. I think that it is particularly undesirable in the case of this administration to assume that because we have not called a press conference and made a public statement we have made no protest or failed to make clear our interests and our desires. (Applause)

JAMES D. ROBINSON, III: Chairman Volcker, the Federal Reserve and some others have expressed concern about the rapid growth of money market funds. Can you tell us something about the Board's concerns and what remedies you're considering?

THE HONORABLE PAUL A. VOLCKER: Well, let me put it in a slightly different context. Money market funds are certainly growing very rapidly. I think one concern, potential as much as present, is whether we have growing up here at this point essentially a substitute banking system running a transactions' business, a checking account business outside the normal burdens and privileges that accompany that operation. We're watching the situation from that point of view. And I think there is a legitimate question among the institutions that are competing with money market funds, whether there's equitable, logical, consistent treatment here. My own view is that equitable, logical, and consistent treatment wouldn't necessarily very much affect the growth of money market funds. (Applause)

CHAIRMAN EDMUND T. PRATT, JR.: Ambassador Kirkpatrick, Chairman Volcker – Jeane and Paul – thank you so much for being with us this evening. You've given us a classic Economic Club evening. It's important for this audience to know your thinking and your feelings about the major issues of the day. Indeed, we might even be able to help. Finally, it's my pleasure and a tradition of the Club to present to each of you, as a souvenir of your evening in the Big Apple, a Steuben glass apple. We hope you'll think about us and keep it on your mantle. Thanks again for coming. Goodnight.