PAUL VOLCKER, CHAIRMAN, PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, IS INTERVIEWED THE ATLANTIC ECONOMY SUMMIT 2013

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SPEAKERS: PAUL VOLCKER,
CHAIRMAN,
PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD

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(UNKNOWN): Thank you, Jean (ph), and good afternoon to all of you. It is a great pleasure to e here today, on behalf of the Center for Audit Quality and we're very happy to be an underwriter of this great event.

Our mission at the CAQ is to server investors, public company auditors, and the capital market. So on behalf of the CAQ, it is a great honor to introduce today's keynote speaker, Chairman Paul Volcker. Following his remarks, Chairman Volcker has graciously agreed to an interview with James Bennet, Editor in Chief of The Atlantic, so we have a lot to look forward to.

As a much-admired public figure, we all know some of Chairman Volcker's many achievements over the course of his illustrious career. He is perhaps most well known for his nearly 30 years' service to the federal government, which included stints at the Federal Reserve Bank of New York, and of course, the Department of Treasury, and capped by two terms as chairman of the board of governors of the Federal Reserve system.

But there's probably a lot about his career that you don't know. Did you know, for instance, that in the early 1990s and then again in the year 2000, his vast knowledge of economics was put to use by major league baseball owners and the players' union. Right? Nothing (ph) new. Or, closer to home for the CAQ, that Chairman Volcker was the founder and the first chairman of the board of trustees of the International Accounting Standards committee.

In that capacity, he oversaw a renewed effort to develop consistent, high quality global accounting standards; an enormous undertaking that continues to this day. And of course, as mentioned earlier today, Chairman Volcker continues to contribute to efforts to make our capital markets more transparent and fair for all investors.

In November 2008, President Obama chose Chairman Volcker to head the President's Economic Recovery Advisory Board, where he vociferously argued that allowing banks to engage in high risk speculation created an unacceptable level of systemic risk. Chairman Volcker's position, otherwise known as the Volcker Rule, ultimately was included in the landmark Dodd-Frank Act.

This just touches the surface of Chairman Volcker's many, many significant contributions in a wide range of issues and that what -- that's what makes him the perfect keynote at The Atlantic's 2013 Economy Summit.

Please join me in welcoming Chairman Paul Volcker to the podium.

(APPLAUSE)

VOLCKER: Yes. Thank you, thank you. Thank you, Cynthia; thank you, Steve, ladies and gentleman. Yes, you are quite a group of presenters here today. By the end of the day, maybe I'll have more optimism about the future of the economy and analysis and all the rest.

But we do have a few challenges. As I thought about what I could usefully say to you today, I decided to reread my remarks that I made to this group last year. That was a mistake.

(LAUGHTER)

It was a mistake, not because I thought it was a terrible speech, but it reminded me of how little has changed since you met here last year. I know we've got a little lift in the economy. I see a real lift; I hope certainly a psychological lift, with the better employment statistics last week, but basically, things have not changed very much.

We're not sure as to how we get out of the economic mess, not just in the United States but more in the developed world; high unemployment, massive monetary stimulus, stagnating income for almost everyone except those in Washington. That's not what my text says. It says for those at the top, but I tell you; Washington is an exception in terms of the prosperity of this city, for reasons we won't explore.

We have unresolved budgetary problems, European and Japanese economies are flat and maybe slipping back into recession; not such a pretty picture. I think we now do well understand that the breakdown of the modern financial system has contributed to the problem.

Among other things, it's left in its wake too much debt, too much leveraging; there has been a focus on financial reforms. And that's home base for me. But the work's only half done, so let me talk about that a little bit.

Some important areas really haven't been touched. Since you mentioned international accounting, I confess I've got a particular interest there, but it's one area that has not been touched. Auditing practices have problems of their own; credit rating agencies, money market mutual funds. That's some of the important areas that're receiving too little attention.

We do have a lot of talk about bank capital rules. We've had years of work on that at Basel and elsewhere, but it still remains incomplete. Important parts of the Dodd-Frank legislation need to be nailed down; parts dealing with derivatives in particular and, yes, the part dealing with the Volcker Rule, and most importantly, which you have discussed already, too-big-to-fail.

Now I do know a lot and it pretty much parallels what I said to you a year ago, which suggests there's something obviously wrong; something going wrong with the whole attempt to achieve reform. Now I know the complexities are inevitably great and there need to be some areas where you need international coordination and cooperation to get things done. That's certainly true in the capital area.

And in some areas, but not all, there are big differences in orthodoxy and irreconcilable views about the usefulness of some reforms. That is true to something you did touch upon earlier; the idea of putting really draconian limits on the size of financial institutions, whether they should be broken up. It's also true, really gross excesses in compensation in the financial world.

But it's interesting that the old and generally discarded idea of taxing financial transactions is again being debated and debated seriously in Europe, but that's something that I think to be sustained and effective would -- would require much greater application than is under consideration now.

What really troubles me is that none of those complications and difficulties can explain the lack of sufficient progress right here in the United States. The Dodd-Frank law, enacted now almost three years ago, remains, in some respects, in limbo.

In other areas, there still is much common -- where there is much common understanding and need, we've been stuck or even in retreat. Now how do we explain that? We can point to the old bugaboos of intense lobbying pressures.

Those pressures are reinforced these days by the implied financial support for ever more expensive election campaigns. We have extreme ideological positions that make it difficult to reach a common ground and certainly undercut the chances of leadership within the administration and the congress.

What strikes me is a more mundane problem. The problem is not new, but it's now become obvious. There are simply too many agencies and regulators involved in overlapping responsibilities, differing priorities, different governance, and zealous in maintaining their turf.

Take the provisions set out in Dodd-Frank with which I am most familiar; those provisions clearly restricting proprietary training and sponsorship of hedge and equity funds by commercial banks. The essence of the matter is clear enough. Commercial banking institutions providing essential public services and protected by and benefiting from direct access to Federal Reserve support and FDIC insurance should not at the same time engage in more purely speculative activity.

Of course, to achieve that result, the implementing regulations should be uniform to all covered banking institutions. What's so awkward is that the five relevant regulating agencies have overlapping responsibilities, they have idiosyncratic ideas of their own, and prefer -- differing preferred approaches, so we have a stalemate or retreat to an unsatisfactory least common denominator.

The same situation seems to have arisen outside of Dodd-Frank, with respect to regulation of money market mutual funds. It's now well-recognized that those funds, as they have grown, are in practice operating as kind of an invasive exotic hybrid, somewhere between a mutual fund and a deposit taken in (ph) commercial bank. As such, they've flourished outside the normal banking and mutual fund rules and regulations.

Now given their vulnerable; their demonstrable vulnerability to runs in the midst of the crisis and the really devastating impact on the commercial paper market that resulted, the present arrangements are broadly recognized to be a structural weakness in the financial system. The massive federal support required during the crisis simply underscores the need for action.

Now there are reasonable options for dealing with the problem. I think most directly and easily by saying yes, indeed, they are mutual funds and those funds ought to accept the general rule for mutual funds; namely that their assets should be marked to market every day. That or other approaches could be adopted without legislation.

And I might note, there are parallel concerns in Europe and elsewhere, who don't look favorably toward the growth of money market mutual funds. Yet somehow, the relevant regulations -- regulators seem unable to act, even with the encouragement of the new Financial Stability Oversight Council.

Now another effort close to my own experience is languishing, in part for lack of effective American leadership. Here I refer to the Leiden (ph) case and the work to achieve strong and common international accounting standards.

In a world so financially and economically integrated, different accounting standards not only imply substantial added administrative costs over time, but more importantly, impair investment analysis, informed investment decisions, and consistent, disciplined auditing practices. I'm well aware there are some important unresolved technical issues, but I feel they will never be resolved without a clear impetus, setting and time-certain from the SEC.

In recognition of these and other areas where the need for both executive leadership and regulatory authority is apparent, the Dodd-Frank -- Dodd-Frank Act formalized a new coordinating committee under the leadership of the Secretary of the Treasury. I think that's clearly a step in the right direction, but the fact is, the evidence is, so far, that the new Financial Stability Oversight Council will need to provide much -- need to be provided a much stronger mandate and executive leadership if it's really to be effective.

Taken all together, it seems to me time to undertake the review and reform of the regulatory structure that the congress itself refused to address several years ago, when it was considering financial reform. And it seems to me the time has come, if neither the congress nor the administration wants to take on that challenge, then perhaps some people in the private sector ought to get together and give it a little impetus.

In considering the needed action to resolve those apparent institutional weaknesses, I better acknowledge that I've long supported a special role for the Federal Reserve in the regulation and oversight of the financial system.

That role has now been more explicitly recognized and reinforced by a particular provision in Dodd-Frank, establishing a new position on the Federal Reserve Board as vice-chairman for supervision.

The significance of that clear statement should be clear; admitted preoccupation with monetary policy, the parallel role, responsibility, and accountability for financial oversight should not be ignored. That is surely a clear lesson of the financial crisis. Ironically, more than 2-1/2 years later, the new position has not been formally filled. I know that competent and even energetic (ph) does now exist within the Fed, but surely that effort should be institutionalized in accordance with a law almost three years old.

Obviously, the Federal Reserve has come to play and extraordinary role in maintaining the economic recovery. In doing so, it stepped out of the long-established but more limited institutional role of a central bank. Instead of confining its operations to intervention in the money markets and control the bank reserves; the tension is today directed toward massive support, directly and indirectly, of capital markets, and most particularly, the market for residential mortgages.

What it amounts to is that the Fed has become the principal intermediator (ph) in American financial markets. It's acquiring several trillion dollars of securities of varying maturity, on the basis of short-term monetary liabilities that it itself has created. In the common vernacular, that is termed, "printing money".

Those efforts are not unique in today's world. In Europe and Japan, where recovery is weak and the possibility of renewed recession is evident, sweeping commitments have been made to do whatever it takes to hold the euro together and to speed expansion, and in Japan, even by explicitly seeking inflation.

Now all of us in the United States and Europe and Japan and, indeed, the entire world economy have a large state in the success of those really unprecedented steps toward monetary expansion, but equally clearly, there are obstacles and risks. Those obstacles lie notably in the underlying imbalances within and among developed economies and the inevitably slow progress dealing with the overhang of excessive indebtedness and the remaining dislocations in the financial system and the pervasive fiscal deficits. Those are matters, unfortunately, that are not easily corrected or corrected at all by monetary policy, however aggressively that policy may be managed.

Indeed, extreme monetary easing, with the suggestion that the approach will continue indefinitely, could encourage elements of speculative activity, undermining the very process of restored sustainable growth and financial stability. Now I make that point because I believe that the Federal Reserve or any central bank must not minimize or neglect its responsibilities for oversight of the financial system as it devotes attention to the conduct of monetary policy.

In retrospect, a heavy cost has been paid for failure to recognize the implications of behavior patterns and speculative excesses in the financial markets that culminated in the crisis. The complexities and opacity imposed by rapid innovation and financial engineering requires skills and a depth of personnel beyond previous experience and the regulators have to be equipped to attain that.

Now those concerns and finding effective approaches to deal with them are not confined to the United States. I would remind you that the United Kingdom has now totally written -- reversed arrangements for placing responsibility for financial regulation in a single agency outside the central bank. The Bank of England again has a central role to play.

More widely, within Europe and particularly in the Eurozone, efforts are underway to better coordinate and centralize the existing very diffuse regulatory and supervisory responsibilities, and again, a very large role is being assumed by the European Central Bank.

The importance of strong and consistent capital standards internationally has long been recognized. The related approach and new approach of stress-testing, the ability of major financial institutions of major financial institutions to withstand shocks is an important initiative also, and all of this is very much of concern to central banks.

Now there's one key element of financial reform in the United States and elsewhere that does go beyond the mandate of the Federal Reserve or other central banks. That concerns a matter of too-big-to-fail that you've been discussing earlier this morning; the conviction that, faced with the risk of amplifying a financial crisis, large, systemically important institutions will inevitably be supported by governments, with creditors and sometimes management and stockholders protected.

Difficulty, of course, is that such conviction tends to promote precisely the behavior patterns; excessive risk-taking and lack of financial discipline that led to the crisis. Now in that area, to my mind, too little attention's been paid to the promising approach laid out in Dodd-Frank. Substantial progress is being made in developing an orderly, so-called resolution process for large failing financial institutions. That process (inaudible) law is aimed at liquidation or dismemberment of failing institutions in a manner that can provide continuity to the money markets, while stockholders are wiped out, management and directors are replaced, and unsecure creditors are placed at risk.

It's very evident that that cannot be a simple process. It's inevitably complicated by the need to reach consistent and cooperative arrangements across borders. But in this instance, we do, fortunately, have strong leadership emerging. Close working relationships have been developing between the FDIC and the Bank of England and I anticipate that will be extended to the European Union. When that is done, you will have accomplished the key jurisdictions in which the large, significant financial institutions operate.

The intervention by central banks generally and the Federal Reserve in particular does raise unfamiliar risks and uncertainties as I (ph) suggested; in particular, Chairman Bernanke and members of the Federal Open Market Committee admits (ph) lively debates have themselves recognized the possibility of encouraging speculative excesses and imbalances. That is one reason for reinforcing the capacity of the central bank to identify and deal with those who emerging (ph) points of strain and weakness.

The challenge as I see it is not technical, but human; human and political. Experience is clear; steps to initiate more restricted policy approaches as unemployment declines and an economy moves toward its potential is never popular. This time, the depth of the recession, the nature of the prolonged unemployment, and the continuing financial strains and doubts about the fiscal outlook complicate decision-making. It will take integrity and analysis, cool judgment, and a high degree of insulation from political pressures to do the job. Those qualities are, of course, precisely the reason we have an independent central bank.

Need I, at this time, to this audience, emphasize the importance of rejecting the siren song that a little inflation, just a little inflation can be the path to prosperity? Long ago, a wise man, a central banker with long experience set out for me an axiom that bears repeating; an axiom for a central banker. If we hesitate too much about being too soon in adopting restrictive policies, then we will certainly be too late.

Let's get on with the job of completing financial reform by providing the Fed with the authority and tools it needs in creating a fiscal environment that can, in the present timeframe, sustain recovery, while also offering reassurance that over time we can indeed restore budgetary balances. Then we will have solid grounds for conference that the really do (ph) -- recent signs of renewed economic growth can be sustained for the years ahead.

Let me say there is a clear sense, given conditions around the world, that that whole world is looking in our direction for the renewed leadership that it needs. There is a lot at stake.

Thank you very much.

(APPLAUSE)

(inaudible)

(UNKNOWN): (inaudible) we navigate our way over to...

VOLCKER: (inaudible) fall off the...

(UNKNOWN): (inaudible)

VOLCKER: Whoops.

(UNKNOWN): So nobody falls.

VOLCKER: (inaudible)

This looks (inaudible); huh?

BENNET: Thank you very much, Mr. Chairman, for your remarks. I think I get to ask you questions for about 15 minutes or so and then I'm going to open it up to the audience.

I guess I'd like to begin by following up on several of the points you made in your speech, starting with where you left off, with your warning that we should reject the siren song that a little inflation can be the path to prosperity and your warning it can never be too early to act before it's too late.

Is that a hint? I mean...

VOLCKER: Not a hint; it's a very direct statement.

BENNET: But do you -- do you see a real risk of runaway inflation any -- on the horizon?

VOLCKER: I don't see any risk of runaway inflation. No, I don't know how long your horizon is, but I -- I do see a risk of what I consider a strange theory that these all-powerful central banks can play a little game. And when you want to expand, let's have a little inflation; that peps it up. But of course, as soon as it gets a little big, we'll shut it off and then we'll bring it down again.

There is no central bank that I know of has ever exhibited the capacity for that kind of fine tuning. And if they lose sight of the basic role of a central bank is to maintain price stability and stability generally, the game will sooner or later be lost. That doesn't mean you're going to go off on a -- in the next few years on some great inflationary boom. It won't be a boom; the inflationary process.

But this hubris that somehow we have the tools that can manage, in a very defined way, little increases or decreases in the inflation rate to manage the real economy is nonsense.

BENNET: When you (inaudible)...

VOLCKER: Did I say that strongly enough?

BENNET: So there's no way to let it edge up to 4 percent, 5 percent, 6 percent, as you (inaudible)...

VOLCKER: If you begin letting it edge up to -- precisely, we'll let it edge up maybe 3 percent, but maybe 4 percent, maybe 5 percent; the game's lost.

BENNET: How do you explain the persistently low rate of -- I mean, when you whipped inflation, you brought it down to 4 percent and we're about 2 percent now; have been there for a while.

VOLCKER: (inaudible)...

BENNET: Is that a function of the actions by the central banks or is it a function of the globalization of the economy?

VOLCKER: What; the inflation?

BENNET: And other pressures on prices? Yes.

VOLCKER: Well, there's no question, the 1980s, when we -- inflation rate had been accelerating to, what; more or less 15 percent a year. Money was very tight, we had a big recession, interest rates were very high; the inflation rate came down.

Now you asked why did the inflation rate do so well in the next 10 or 15 years, I think global competition had something to do with it. That's right. But it also was on a foundation, not just in the United States, but elsewhere, that central banks had finally decided that it was their basic function to maintain price stability and that message had gotten through to markets, generally, and to countries, generally. And we -- that's still true to a considerable extent and I don't want to lose that.

BENNET: I'd like to move on to the question of financial reform. And you spoke this year and last year that we haven't proceeded as quickly as -- as you had hoped to deal with the problem of too-big-to-fail and you, today, pointed to the problem of overlapping regulatory agencies as one of the big obstacles.

There was a kind of, to my mind, chilling admission by Eric Holder, the Attorney General, last week...

VOLCKER: Yes, yes.

BENNET: ... that the size of these banks is, I think he called it an inhibiting factor when he considers bringing a (ph) prosecution; that is the risk of systemic failure...

VOLCKER: Right, right.

BENNET: ... that our justice department might not criminally prosecute, even when it believes a crime has been committed. So that makes me wonder, is the problem actually that -- that -- that some of these banks really are just too big for our government even to take on?

VOLCKER: Well it was interesting he made that statement and I have been, in my little experience, involved in a couple of occasions when I thought the -- frankly, for different reasons; not because the institution necessarily is so large, but they indicted or were about to indict sizable financial institutions; if Arthur Andersen is a sizable financial institution that did get indicted and -- and we lost one of the major and historically most disciplined of our auditing firms.

It was interesting that the indictment and conviction was later reversed, but, you know Arthur Andersen has lots of sins, but whether it was smart to indict the whole company instead of indicting individuals is a precedent, right? Another example where they indicted a bank and said it was clear that there were miscreants in the bank and they said well indict the people who actually did it later.

And the bank got indicted and merged, so it disappeared; the individuals never got indicted. And you probably -- that had nothing to do with -- in either case, to its (ph) financial collapse. They were -- I think they were misguided indictments where individuals should have been indicted.

BENNET: Yes.

VOLCKER: But there's no question, when you're sitting there as secretary of the Treasury or chairman of the Federal Reserve and you've got a big institution failing and a very complicated, difficult and vulnerable financial institution, the whole tendency is to find some reason to save the situation. And that thought is now deeply embedded in people's minds; apparently in Attorney General Holder's mind, despite the fact Dodd-Frank says no, you can't do it, period.

Now you tell that to a typical financial guy; he said, I don't care what the law says. When push comes to shove, they're going to do it. And so long as that's the attitude, you don't get the benefit of -- of all the things that you can do to try to manage it. And it's more difficult to manage and more things involved and I suggested -- Sheila earlier said the -- the -- the approach is to make it easier to break up an institution if it gets in trouble are very important.

But you're kind of in an environment where people believe that you've managed the situation; it doesn't make any difference because so long as they believe too-big-to-fail is here, they're -- they're behavior patterns will continue. And how can you prove that you've cured the problem unless you've got the crisis and let it happen when everything you're trying to do is to avoid the kind of crisis that makes it relevant? So it's kind of a room (ph) within circle.

But I -- I do think it'd be nice to have a test, maybe not of the biggest bank in the world, but some significant financial institution and find that these mechanisms being worked on by the FDIC, by the Bank of England, by the Federal Reserve, in fact, will work. And I -- I find -- I've convinced myself, for what it's worth, that you can make it work; yes. But I can't prove it to you until we get there.

BENNET: What degree of confidence do you have now that the effect you hope to achieve with the Volcker Rule will ultimately be achieved?

VOLCKER: Well I -- it's in the law, fortunately, and so all this -- we're going about precisely the way the regulation is written; it already had an effect.

BENNET: Right.

VOLCKER: I think it will; it has and it will move the gross speculatively outside of the regulated banking system into hedge funds and equity funds got our -- got their own capital, their own -- their own funds at risk, and that's where it should be and I think it's -- it'll work out fine.

Now there are other, you know, there are other approaches. You can return to Glass -teagall. Glass-Steagall got changed, probably because it broke down, by modern banking, modern finance. You couldn't make the clean distinction that you would have liked to make. You've got the kind of approach that the U.K. is favoring that says it's kind of a contained Glass-Steagall.

It says have pure and simple commercial banks and we'll put all the other activities in -- outside and we'll protect the commercial bank. We won't protect the other thing, even though they're in the same holding company. That's kind of hard to pull off. And then they'll have a big debate, as you have with the Volcker Rule, as to precisely what the borderline is.

But I -- I think either of those are -- both of those approaches are aimed at the same problem of trying to restrict government support on a continuing basis for institutions that clearly are performing an essential public service.

BENNET: I'm going to ask two more questions, so if you have a question for Chairman Volcker, you might begin lining up at the microphone or else I'll just keep going.

If I could ask you about fiscal policy for a second, and specifically the sequester; I wonder how concerned you are that it may be dangerous to the economy. And as clumsy as it is as policy-making, let me pose a false but still kind of realistic choice between the sequester and congress kicking the can down the road and not acting at all on spending in the short term; which would you take?

VOLCKER: I'd be tempting to take what I would call a modified sequester. I mean the sequester doesn't make sense in -- doesn't make orderly sense anyway and, you know, every item of expenditure being reduced by X percent, but if they gave the president the authority to say OK, you've got to reduce it by -- you aggregate by whatever percent they're talking about, but you can have freedom as to whether you're going to close the national parks or close the Defense Department; you can go ahead and do that.

Now I think that there's no doubt in mind you could reduce government expenditures, whether defense or civilian, by the percentage they're talking about if you have time to do it in an orderly way. We don't have much time in this case, so it's not ideal, but hopefully, keep our fingers crossed, that this little better business news recently is strong enough to sustain whatever limited effect the sequester would have on the economy.

BENNET: I wanted to ask you -- this is not directly on point with the economy; a broader question that I think you're particularly well-suited to answer, given the depth of your experience in American public life.

It seems in any period we feel like the government can't get anything done and that politicians are obsessed with their own elections and that partisanship is obstructing our ability to address the questions. We certainly are saying that now.

Do you believe that, in fact, our ability to devise substantial policy in response to substantial challenges has deteriorated in absolute terms over time?

VOLCKER: Yes. It looks that way. I don't know. I hope it's different over time, but, you know, give -- I, you know, I used to live in Washington part of my life, but I don't live in Washington now and I come down here as little as people. When you come down here, it just physically -- it hits you. I mean it's the most prosperous city in the United States. What's its industry? Lobbying. That's its industry; right?

You know, hotels up, big mansions all over the place, I -- there is more money involved in this than there was before, and more, it's come back to the campaign expenditures. There's more money needed for campaign expenditures, which gives the lobbyists more leverage than they ever had before and it shows. And I think it makes it -- take this -- my favorite, I know; money market mutual funds. They're like an invasive weed.

I mean they're not regulated; they got in under the regulatory structure. They -- convenient for a lot of people. They have thrived. They've had problems. It's a big problem they had in -- in the midst of the crisis. But all things considered, it's a small industry; not many people's lives are -- economic lives are dependent upon running money market mutual funds. It's a convenient adjunct to some other businesses.

But every agency, one way or another, with the exception of the SEC, which kind of got blocked by two-to-two votes or something; every agency has said they don't like them. The -- this new council has pronounced that the agencies ought to get together and do something and nothing gets done. I mean, here you -- it's blocked by one agency, apparently. I mean it doesn't even take legislation.

BENNET: Let's go to the floor please.

QUESTION: I'm Stuart Brown with Warren Capital. It occurs to me that home prices wouldn't be depressed if there were too few homes, so with the Federal Reserve extending some piece of its $80 billion a month toward buying mortgage-backed securities, is there a rule or a law that says they couldn't make some of that accessible, saying we'd like to buy water and sewer bonds. We'd like to buy higher education, health and education bonds. We'd like to buy port authority bonds, so extending some of that money towards infrastructure.

VOLCKER: Well, I think the general ideas are -- and this kind of question are that the United States has big infrastructure needs that aren't being taken care of and you suggested infrastructure needs in connection with residential development. In some cases, sewer pipes need to be changed and water pipes need to be changed and all the evidence is we've slipped in that direction. So if you're going to spend more federal money or even reallocate federal money, that's a good way to do it. I agree with that.

There is discussion of some kind of an infrastructure bank. I think it's an interesting idea. I think it's got limited potential, but some potential. And when you get to the kind of infrastructure you're talking about, then the question of tax exemptions for state and local securities arises. And when people talk about tax reform and tax expenditures, this is one of the ones they talk about. So you got to ask yourself whether eliminating tax exemption is a good idea or a bad idea if you're interested in infrastructure.

BENNET: Please.

QUESTION: Well, sure and on that note, I want to ask another question. Back when you -- in the 1980s, when you were wrangling with different problems than we have now, you wrote a book with Toyoo Gyohten from Japan about the challenge from global competition that you saw as arising (inaudible) ...

The challenge today ...

BENNET: Can you slow down and...

QUESTION: Sure.

BENNET: ... speak into the mike, please.

QUESTION: The question I'm trying to get to from some of this is that today there's far more tax and competitiveness globally and I was struck by the fact that Alice Rivlin didn't talk much about how the United States has the highest corporate tax rate in the world and that means that now investment dollars are chasing more attractive places for investment because of the tax restrictions.

VOLCKER: Corporate tax rates -- it's obviously out of whack. The nominal rate is very high compared to other industrialized countries and -- industrialized or unindustrialized countries and obviously the effective rate is much lower, because there are so many exemptions there in equivalent tax expenditures and I -- I'm very much in favor of getting a greatly lower rate, no higher than the average of other OECD countries, which is 25 percent or so; maybe a little lower, closing some of the loopholes, hoping you don't lose much revenue in the process.

But I wouldn't run -- I mean would except some loss of revenue, if you did -- and I don't think it would be much; if you lowered the rate to then (ph) exemptions and I'd apply it worldwide, which would be now without getting in the mess of -- you didn't do it, American companies would be paying very little tax to the United States for their foreign operations, because they'll be taxed where they're working and they get a credit for that, so the impact on the foreign investment should be neutral.

QUESTION: Thank you.

QUESTION: Hi. I'm -- I'm Akio Fuji from NIKKEI Newspaper. My question about central banks' independence; relationship between government and the central banks. Relationship (ph) many governments in developed countries pushing central banks to ease monetary policy; recently Bank of Japan was pushed by new prime minister who knows -- was in ECB, German (ph) (inaudible) bank's power seems to (ph) diminishing.

So how do you see this trend? Is this dangerous trend or a better trend? I think you have tension between government when you are in Federal Reserve.

VOLCKER: Well, let me say a word about the independent central bank, which obviously I said is important. But when the central banks depart from their more traditional role, as they felt forced to do during these difficult problems, it will -- if that was maintained over a period of time, then you really raise a question of the independence of the -- of the bank, because they're getting into the allocation of resources and their dominance in the market in a way that really isn't intended and was associated with independent central banks.

Now in Japan, there's describing (ph) remarks I made about inflation, I've directed many, many toward -- toward Japan, frankly. His (ph) Japan got a new government that's going to solve all their economic problems by -- before he got elected, saying he wanted 4 or 5 percent inflation and I think he was going to direct the central bank to achieve that, as if the central bank could achieve that. I'm not sure they could in the short run.

But he's retreated a bit, as -- retreated some, I think, from the threats about the independence of the central bank, but he has appointed a new governor; the governor's term was up and he waited until the existing governor's term was up to appoint a new one. That's all part of the law, so your concern about the independence of the central bank, I think, has been alleviated a bit. You can still have concerns; we'll see what the policies are, but I'm glad, at this point, that he felt he had to refrain from attacking the independence of the central bank directly, as he kind of was suggesting he might do in his campaign.

BENNET: I screwed up; I'm sorry. I didn't realize a line was forming to the left here as well, so we'll take two. I'm disadvantaging you now and I apologize for that; two over here and then.

QUESTION: I've got a question (OFF-MIKE) Fed chairman is less than (OFF-MIKE) monetary easing. Here's my (OFF-MIKE). Now the Fed (OFF-MIKE) Operation Twist (OFF-MIKE). If they were to raise interest rates (OFF-MIKE) United States; let's say raise about 3 percent. Let's say that (ph) debt is (OFF-MIKE); that an average increase in interest (OFF-MIKE)

VOLCKER: Well, look, I haven't done all the calculations that would be necessary in all the different hypotheses about what might happen to interest rates, but I did read online this column, I guess, this morning, coming down on the plane. It depends upon how the accounting goes, how high interest rates got and all the rest.

And you could easily imagine situations where they would not be reporting a profit. And if they were not reporting a substantial profit, they presumably -- I don't know what they'd do, but they presumably would not give earnings to the Treasury. Right now, they're giving a lot of earnings to the Treasury, 'cause they're minting money, almost literally minting.

But, you know the world hasn't come to an end with other central banks. If you mark the rest as to (ph) market, they would be negative capital. I don't know what that would -- what assumptions you would have to make here, where the interest rates were, whether they were actually selling or whether they weren't selling, as to whether the Federal Reserve would ever show a book loss, so to speak.

QUESTION: Still, yes, but the bigger part of the equation would be additional interest expense (OFF-MIKE)

VOLCKER: Look, but if interest rates go up, they're going to be more interest expense for the United States Treasury and loss of Federal Reserve profits too. And people looking at the budget have to keep that in -- in account, because it's a big item if interest rates return to what should be considered normal; no question about it.

BENNET: Thank you. Can we move to the next question?

QUESTION: Hi. My name is Michael Kirsch from the Executive Intelligence Review.

My question is about nation-building and the need for a credit lending institution that could determine more of the guiding boundaries of the economy; not just a small infrastructure thing, 'cause when Franklin Roosevelt took the banks through the reorganization in 1933, which we haven't done yet; we've just done regulation.

But when he did bankruptcy reorganization, he also had a plan for 12 credit banks, one in each Federal Reserve district that would directly lend for industry when it was needed to build new economy at that time. That didn't happen; that became section 13b...

BENNET: Can you move to your question, sir? I'm sorry; yes.

QUESTION: Yes. He -- the Federal Reserve did lend in that time, section 13b, for industry and then that -- and also the reconstruction finance corporation. But the -- the -- the history of the United States, when we have gotten out of crisis has been to look at the bank of the United States with (ph) Hamilton, the Bank in the United States with (ph) John Quincy Adams and (ph) Biddle (ph), and then even Lincoln; his economists said that the (inaudible)...

BENNET: I've got to ask you to get in -- to get to the question. I'm sorry, sir.

QUESTION: It's just that if you look at all of our history, we've had some big institutions that directly lent, not just a central bank like the Fed, but a bank which determined the economy and directly lent to credit institutions. Isn't that something we need, looking at our history?

VOLCKER: Well, I -- I mean I suppose the question is -- if I understand, the question is why didn't (ph) the Small Business Administration be more effective? We have a -- we have an institution of that type and you can argue about how big or how small it should be, but I don't think it should be the Federal Reserve's function.

BENNET: Let's go over here, please.

QUESTION: Mr. Chairman, Norman Kurland from the Center for Economic and Social Justice. You gave a good case of the difficulties that we're having in terms of having a -- checking the price stability as -- as being a central function of a -- of the Federal Reserve and other central banks.

Now the question is, given all the problems that we're having, to what extent do you think there's the possibility that the U.S. dollar will no longer be the world currency? To what extent and to what -- and what kind of problems would be exacerbated if that occurred?

VOLCKER: Well, you know the -- the way the strange, unhappy or happy, depending how you look at it; the dollar does at well as it does, we worry about our economy, but our economy looks good compared to the rest of the world, so the kind of question you have has not been pressing.

But I think, you know, you can abuse unduly the -- that exorbitant view that you have of having a reserve currency and not having to pay your bills internationally too far or, at some point, the stability will come into question. I think that'd be bad for the United States and bad for the world.

I'm not going to -- the question is too complicated to -- to deal with an easy answer, but -- there is not easy answer, but I -- I do think there has been a neglect for years of the operation of (ph) the international monetary system, which just comes down to nobody's paid any attention to it for some years and I think that's going to bite us at some point, because it should not be so dependent upon the dollar alone and not -- should not be so permissive about our ability to borrow.

BENNET: They're trying to cut us off, but if we could move quickly, I'd love to get these last two questions in, so please go ahead.

QUESTION: My name is Tom Kaddell (ph). I'm a research (OFF-MIKE). You mentioned in your speech that financial engineering has become so sophisticated that regulators can't keep up. And your comment reminded me of (OFF-MIKE) that increasingly sophisticated drug initiatives and most recently Lance Armstrong.

Is there a Lance Armstrong in the financial system and should we not hold them responsible for their actions?

(LAUGHTER)

VOLCKER: Are then suggesting financial engineering is the equivalent of drugs? Maybe it is; I don't know.

QUESTION: In terms of regulators trying to keep up (inaudible)...

VOLCKER: Oh, I -- I -- yes, I see -- I see your -- I will make no comparisons with the -- Lance Armstrong. There are enough problems with the financial system without getting into the world of cycling. We recycle; we don't cycle.

BENNET: Can we get to the last question, please? Thank you.

QUESTION: Steve Thangle (ph) with the Banking Economics and specialist on Hyman Minsky's financial instability hypothesis. To what extent should the mandate for price stability extend to the of asset prices when compared to consumer prices?

VOLCKER: Boy, I'll tell you my (inaudible)...

BENNET: Can you give it to us again? I had trouble...

QUESTION: You mentioned the mandate the Federal Reserve has for price stability. I'm asking...

BENNET: Price stability.

VOLCKER: Yeah.

QUESTION: I'm asking what about the stability of asset prices in comparison to consumer prices?

VOLCKER: Let me just answer that question this way; maybe not satisfactory. When I -- people talk about stability; when I talk about stability, I'm often thinking of, yes, price stability by some measure. But the word stability in my mind encompasses financial stability; something more than price stability and the stability of financial relationships, institutional relationships and all the rest. And when you use the word stability in that context, which I -- I do, then I get worried about the -- the excesses that might arise and the Federal Reserve should worry about them.

Doesn't mean it's easy to deal with them. There's a big matter of judgment as to, first of all, when you identified some unsustainable boom in some sector of the economy, and even if you identify it, what do you do about it? They're both difficult questions, so they're both questions I think can't be ignored. And I think the Federal Reserve now realizes that.

BENNET: Thank you, Mr. Chairman, very much for your time.

(APPLAUSE)

(UNKNOWN): Big round of applause for Paul Volcker and for James Bennet. Thank you so much, Mr. Chairman, for joining us. Thank you all for joining as well; particularly those people who are watching online.

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