

MR. VOLCKER: Well, thank you for those overly generous comments from the two Chairmen.

I must say when I walked in here and realized the distinguished nature of the panel and I realized this setting, I am totally intimidated, but I will try to proceed.

The building reminds us of the days that banks were banks. They had a certain solidity to them, but on the Internet we don't have this kind of, I think, physical surroundings.

Let me say I've had a chance to read the statements of some, if not all, of your previous witnesses, and you'll be relieved to know I don't have anything to add by way of facts --

(Laughter.)

MR. VOLCKER: -- or analysis.

Obviously the questions that you have before you come down to matters of judgment. Let me repeat a couple of points that they've made. I think in an ironic sort of way the combination of open markets, which members of this panel have had a lot to do with, and the sluggishness of the rest of the world has contributed to the amazing economic performance of the United States.

It certainly has been a factor that has kept our inflation down as we have expanded so rapidly.

And of course, it is obvious that the growth of the United States in combination with the sluggishness elsewhere has been a key factor, I think the key factor and the dominating factor, in the rising current account deficit.

And finally, I think looking at what's going on, I am not prepared to say that a four percent of GNP current account deficit may not be sustainable for a long time.

Now, having said all of that, I've got a big "but" here in my notes. If it's going to be sustainable for a long time, I think that would be dependent on an imbalance in the world economy that we would not like to persist forever. I think it is a symptom of low savings, particularly low private savings that should not persist forever. It is a very large drain on total supply of world savings, which that drain should not persist forever.

We have a situation where, from a welfare standpoint, the money is running uphill from the poor to the richer. I think it was Herb Stein who pronounced the immutable economic law that things that are unsustainable will not be sustained.

(Laughter.)

MR. VOLCKER: I have a somewhat less immutable law. Things that shouldn't persist forever

probably won't persist forever. The real question is when and in what form the inevitable adjustment will take place.

I will be exceedingly modest in making a forecast. If you'd asked me that question ten years ago, I would have said long before the year 2000, but here we are, and it has persisted at least to the year 2000.

Now, I think we will some day have to adjust this current account deficit or a large portion of it. There are two factors that would decidedly add to the risk both in terms of speeding up the timing of the adjustment and producing an adjustment that would make a severe and adverse impact on the U.S. economy.

Now, one of those factors is not directly or even very much indirectly in our control, and that is the speed of growth elsewhere in the world, how soon they will want to more fully employ their own savings and their own production, adding to potential inflationary pressures.

The other factor is within our control, and that's the performance, of course, of our own economy.

The stability of our economy, the stability of prices, and the stability of the financial system comes down to, in part, the current situation whether we will have what I will define as a responsible budgetary policy

that is under the control of the administration of the Congress. For the moment I think that means sustaining our surpluses. It's a question of monetary policy and its performance in sustaining orderly growth, and it comes down to financial stability.

And I have to say when I look at the stock market, that comes down to a question of animal spirits.

(Laughter.)

MR. VOLCKER: And how they behave.

Now, the good news, from our narrow perspective anyway, is that growth in the rest of the world will remain modest to moderate, as near as I can see. It doesn't appear to presently be a big threat of tightening financial markets abroad or insupportable demands on good markets for a reasonable period of time ahead.

I think our budgetary position looks good. That helps quite a bit in sustaining this situation. It provides some savings at home, reduces pressures on financial markets, maybe most importantly maintains and reinforces confidence in American policies and stability, an important factor in the ease with which capital flows into the United States.

I cannot avoid saying I think there is a big wild card in the stock market. I can't believe

that what we see in the high tech area of the stock market is not one big bubble. The rest of the market is much more reasonable it seems to me in its valuations. It didn't appear that way so much a year or two ago, but it appears much more that right now.

You know, the cliché summary is do we have a hard landing or a soft landing. I don't think any of us know that answer for sure, but I do think we know some things, and I'll conclude with that.

I think it's important to keep growth in the American economy within bounds, within what is consistent with reasonable price stability, and we do need to be cautious on that front now.

As I've already suggested, maintaining a budget surplus under current conditions is important. We should do what we can, however modest, to sustain growth abroad. I don't think there's any danger of that growth becoming excessive in the short run.

There is an area that I have been concerned about as a structural matter, which won't be repaired in the short run. The instability of currency values right around the world, which we have seen demonstrated time and again not just in the developing world, but between the two biggest currencies of the world, the yen and the dollar, and at times between the European currencies and the dollar presents a kind of a wild

card in the situation. If a change in our economic circumstances or others' economic circumstances leads to a violent change in currency values, that could be a factor destabilizing investment flows and creating a more immediate problem than anything that seems to be on the horizon at the moment.

So I would just stop there, if I may, Mr. Chairman, and be glad to respond to any comments or questions you have.

CHAIRMAN D'AMATO: Thank you very much, Mr. Chairman.

I would remind people to speak into the microphone because the acoustics here are good if you speak very close into your microphone.

Commissioner Krueger.

COMMISSIONER KRUEGER: I hope this is audible.

You worry about the currency values, and of course, this Commission is charged with worrying about the current account deficit. What policy prescriptions, if any, would you think would follow from that concern? Are there things you can see that might be recommended that would reduce risks in terms of currency fluctuation?

MR. VOLCKER: Well, are you referring to the exchange rate, your question in particular?

As a matter of forecast, I don't think anything is going to be done in any reasonable time period, much to my regret, I think the world would be better off if we made a greater effort, which I happen to think is possible, to confine exchange rate fluctuations within a range that 20 years ago I would have thought were very large, but in terms of what's happened recently I think are rather modest. Let's

say, a range of plus or minus ten percent or maybe even plus or minus 15 percent from some kind of generally defined equilibrium value, could be sustained. I'm making an assumption here that that's possible, which I believe it is. If we make that assumption, then the risk of an even more violent change in exchange rates that would overshoot the mark, so to speak, in terms of any current account adjustment problem would be minimized more importantly, I think it would avoid the risk of a kind of cascading deterioration in confidence that would have adverse repercussions for monetary policy and interest rates and come back and damage prospects for sustaining growth.

COMMISSIONER KRUEGER: Thank you.

CHAIRMAN D'AMATO: Commissioner Wessel.

COMMISSIONER WESSEL: During the run-up and during the negotiations of the North American Free Trade Agreement there had been some discussion of the need to address currency issues as part of those trade negotiations with a concern about the possibility of a devaluation.

We're now engaged in an effort within the WTO to bring China in, and as we've seen over the last several years with the Asia crisis, there were a number of high-level Administration discussions to try and avoid China devaluing its currency.

Do you think it's appropriate as we move forward on trade negotiations either in the multilateral or in other settings to try and create whether it's these bands, I guess you talked about, the currency bands or some guidance as to how we might deal with currency devaluations as part of trade negotiations and market opening in the future?

MR. VOLCKER: Well, I don't know if I would do it directly as part of the trade negotiations. I would certainly like to see some discussion about it internationally, but I don't think I would combine the negotiations.

I think your mention of China is interesting because it seems to me it's a perfect example of the intellectual and practical confusion in this area. The reaction to the Asian crisis by many, I think, was to say, "See how important it is to have floating exchange rates and flexible exchange rates?"

But when it came to the biggest country in Asia, China, they said, "See how important it is to absolutely fix the rate and don't let it move an inch or we'll have a great crisis?"

I mean I don't see how you reconcile those two views, frankly, and I think it does reflect a certain amount of intellectual confusion.

I think the way we are drifting, for better or worse, is that we will get more stability in exchange rates and actual fixity among a lot of small countries that can cling to a big country. The obvious example is potentially, let's say, Mexico whose trade is very heavily involved with the United States.

There is a lot of discussion in the business community of Mexico about desirability of fixing to the dollar and actually adopting the dollar.

I don't think that's going to happen in the short run, but one more crisis and I think it will happen. Given the frequency of crises in Mexico, it's a pretty safe prediction there'll be another crisis at some point.

There is even a little discussion in Canada. Obviously Ecuador has a big problem with polarization. I hate to call it a crutch, but maybe it's a crutch in their case. Then you have the European countries, the satellite European countries, Eastern European countries which I think are naturally attached toward the Euro. Eventually some of them, of course, will become members of the European Union.

It's much harder to talk about that in Asia because there's no natural anchor currency. So what happens there in the next decade or so is very much up in the air it seems to me, and it gives an air of instability which doesn't help, I think, in sustaining

growth in that part of the world. I don't think it helps American business or American labor either to have that kind of instability in competitive positions.

CHAIRMAN D'AMATO: Commissioner Weidenbaum.

CHAIRMAN WEIDENBAUM: Thank you.

I'd like to return to your comment earlier about confining exchange rate fluctuations. As you know there's a school of thought that says given the tremendous volume of private, nongovernmental transactions in foreign exchange markets, that would swamp any attempt by government, no matter how large, including our own, to alter the trend of the foreign exchange value of the dollar.

Would you be concerned should there be an effort to confine exchange rates fluctuations to a narrow band, that it would be ineffective? Would that upset investors far more than a laissez faire position?

MR. VOLCKER: It can't give rise to much more volatility than we already have between the yen and the dollar, if I may say so. That would be hard for me to imagine, but obviously many people -- I must even confess most people -- do not share my view that you could potentially stabilize within what we're talking about which is very wide band.

I think you can today because the market promotes such wide fluctuations because the

participants don't have the vaguest idea where an equilibrium lies, and they get no official guidance as to where the equilibrium lies, and they get no response in policy in those terms. That creates a field day for speculative forces to ride market movements in either direction until the change is so great that somehow it changes direction. I think we can do a little better than that.

I think with the kind of ranges I'm talking about the market could become convinced that they are reasonable. They would have to be supported by governmental policy in some instances, which means maybe in the -- I was about to say the last analysis, but maybe in the first analysis, too -- monetary policy would have to, to some degree, take this into account.

I don't think it would create any violent conflicts ordinarily.

I find in my experience that these wide swings in exchange rates will more frequently than not give an appropriate signal for monetary policy rather than the reverse. That is not true perhaps in every single instance you can cite, but in my experience and the major turning points, it has been.

So I have a certain faith that the market will respond in a stabilizing way rather than a destabilizing way.

CHAIRMAN WEIDENBAUM: What is the special ability of government to determine the equilibrium foreign exchange rate that the market doesn't possess?

MR. VOLCKER: Well, I don't know that it's got any special competence, but I think you ought to have enough competence to aim within the 30 percent.

CHAIRMAN WEIDENBAUM: Okay. Thank you.

CHAIRMAN D'AMATO: Commissioner Angell.

COMMISSIONER ANGELL: Paul, I would find it very helpful to have a recommendation from you in regard to what you would like the Commission's main thrust of our report to the Congress to be, and if you like, what you would like not to see in the Commission's report.

MR. VOLCKER: Well, I should go back and look at your particular frame of reference, but I would like to see a firm statement that this current account deficit is nothing that's going to be repaired by protectionist policies and we should not move in the direction of selective controls or interference with the market in that sense.

I do think you, and I hope you will, emphasize the importance of fiscal prudence. In the present situation in particular where private savings are so weak, we need to maintain the budgetary surplus

that we happily have achieved. I think it has been a big factor in helping to sustain this economic advance.

I think you should make some reasonable comments about the importance of, as best one can, maintaining economic growth within reasonable limits of tolerance, taking account of the fact that we had benefited from -- I hate to use the word "benefit from" -- sluggishness of the rest of the world. As the rest of the world grows, we will have to be more cautious about our own demand path because that's been spilling over into all of these imports, which won't be so easy as the rest of the world expands.

So I think those are some of the fundamental points. If I were so bold, if you wanted to make some comment about the desirability of doing some thinking about the possibilities of stabilizing exchange rates, I would be overwhelmed with happiness.

(Laughter.)

CHAIRMAN D'AMATO: Mr. Chairman, may I ask just a quick question on institutional arrangements? Trade agreements have become a rather robust cottage industry in Washington. We've had about 350. We spent a lot of time negotiating agreements, and there's some growing concern as to our ability to really enforce them effectively and whether we have the institutional arrangements to enforce them.

Do you think given the fact that trade has now become a varsity sport at the end of the Cold War that it's important for us, particularly with the debate over our relations with our Asian partners, both Japan and China, in terms of the enforcement of the agreements that we sign with them that we put an emphasis in this Commission's report on restructuring or reinvigorating the agencies that could actually do the enforcement.

MR. VOLCKER: Very much, and I'm glad you raise that point. You have experts on this Commission that know far more than I about the details of the WTO and other arrangements for settling disputes and conflicts, but I don't have any doubt that if we want to live harmoniously with the rest of the world, we're going to have to put more weight on these institutions rather than the reverse.

And I think whatever recommendations you can make to strengthen those institutions and strengthen particularly their dispute settlement powers in a way that is fair and reasonable, I think that would be very useful.

We always sit around complaining that other countries are the principal sinners in this respect, and we are less so. I happen to think that's been true in the past. It's probably still true, but we ought to

be able -- and I think there is some evidence that we can -- to rely upon the WTO procedures, cumbersome as they may be to produce results that are not adverse to the American interest.

CHAIRMAN D'AMATO: Thank you.

Commissioner Becker.

COMMISSIONER BECKER: Yes. Thank you, Mr. Chairman.

Mr. Volcker, I hear time and time again this discussion on the extraordinarily low savings rate in the United States. Help me come to grips with this.

What are we really talking about? We're talking about individual savings?

What should they be saving? What aren't they doing what they should be?

You know, I look at this as a family. My kids don't save a damned thing, they never have. I save maybe enough for both of them.

MR. VOLCKER: That's right. You're in the same position.

COMMISSIONER BECKER: What are we talking about. Is this national savings, individual savings? How shall we relate to this?

MR. VOLCKER: Well, I think we face this kind of accounting identity anyway, which I know there was some discussion about earlier, that if we want to

invest we've got to save, and "we" is subject to interpretation. If we the people don't save, the individuals and corporations, then the government has to do it or we're going to have to draw upon the savings of the rest of the world.

Now, what we're doing right now is that the government is doing some savings, but we're mostly drawing upon the savings of the rest of the world. There are reasons for that.

We are the bright spot in the world economy. We attract those foreign savings very easily. We don't have to force it out of them. They are pouring it into us, and that's all right so long as it lasts. I think the vulnerability we face is that that will not and should not last forever because the poorer areas of the world certainly have room and need for their own investment and to use our savings rather than the reverse if we had any as the richest country. It's rather ironic that with all our wealth we don't do the savings. The rest of the world fundamentally needs the savings more than we do.

So I don't know there's any -- I can't give you an explicit number as to what we should save, but I don't think it's a matter of just a forecast. We can't count on getting the savings from the rest of the world so consistently and so easily as that's been the case

in the last decade, nor should we want to because I think we have a long term interest in seeing the rest of the world growing up, too.

COMMISSIONER BECKER: Well, if I could carry that one just one step further, credit card debt is reaching astronomical figures. It's not uncommon for workers to have two and three credit cards and stretched out to the very limit. They just pay the interest on them.

If I would present this to my members or throughout the AFL-CIO, the first thing they'd say, "Well, we need more money. We need to be paid more if you expect us to save some."

Is this a possibility for our workers to save this kind of money to eliminate the debt or are we just talking about rich people? Are we talking about the government?

MR. VOLCKER: Well, if you're going to increase individual savings, you're going to have to do it on a pretty broad basis. You just can't count on a few rich people. There are obviously a few rich people that are getting extremely rich, and they ought to do their part.

I haven't addressed all of the issues in the American economy in my brief comments, and I suppose you haven't either in your deliberations, but

it is a fact at least until recently that the typical working man in the American economy has not shared anything like the same degree the increase in incomes and wealth that other areas have participated in.

I don't have much doubt that if we readdress that balance a bit, however it can get done, consistent with reasonable policies that you would find more savings by the working man and woman than you find right now because they have been squeezed to some extent or at least they certain have not prospered to the same extent until recently.

Now, there are some signs that that's changing. So maybe that's a hopeful sign. I don't think there are many signs that the savings rate has been increasing unfortunately.

CHAIRMAN D'AMATO: I think we have time for two more questions.

Commissioner Zoellick.

COMMISSIONER ZOELLICK: Thank you, Mr. Chairman, for taking the time to be with us today.

I would just like to explore a little more your notion about targeting the exchange rate with monetary policy, and I was just trying to think about the situation today where the Euro has fallen relative to the dollar.

And to deal with that, I guess you would want to lower interest rates in the United States, which doesn't seem to be too sensible to me at this point, or increase interest rates in Europe, and while I think that may happen over time, it certainly shouldn't help growth in Europe and, therefore, wouldn't help too much to increase our exports to Europe.

So maybe if you could, using the current situation, give me a better sense of how you would use monetary policy to target the exchange rate.

MR. VOLCKER: Well, see, I might decline your kind invitation because I think part of the reason we're where we are is that we have been in a kind of disequilibrium, volatile situation in exchange rates, and we may not be in this situation if we hadn't had the particular history that we have had.

But in terms of Europe, just to take your bait a little bit, I'm not sure the Euro is that far out of the kind of range or maybe not outside the range at all that I would think is appropriate. It may be reaching sort of the lower limits of what I might think is appropriate, but I'm not willing to push it back in a very narrow range, and you know, it's been between what, 120, the dollar and 96, whatever it is now. It's the 20 percent range roughly.

So I'm not sure this is -- it's unlike the yen fluctuation. That literally was 50, 60, 70 percent at times.

COMMISSIONER ZOELLICK: thank you.

MR. VOLCKER: I'm not comfortable with it, but it's not an extreme case of disequilibrium.

CHAIRMAN D'AMATO: Commissioner Lewis.

COMMISSIONER LEWIS: Thank you. Thank you very much for your instructing us on what you talked about.

You just said a few minutes ago that the drawing down of the world savings would not and should not last forever. Could you give us your view by the increased consumption over savings? Again, we're drawing on the world savings, and you said it should not and would not last forever. Could you give us your views on how you see this adjustment occurring and what you think will be the impact on the United States?

MR. VOLCKER: I just missed something. Give me your view on?

COMMISSIONER LEWIS: Your view on how this adjustment will occur if we don't --

MR. VOLCKER: Adjustment in savings will occur?

COMMISSIONER LEWIS: If we don't keep drawing on the world's savings, you said it would not

and should not last forever. What do you foresee happening when this adjustment occurs?

MR. VOLCKER: Well, of course, what you would like to see happening from some grandiose look at the world anyway is certainly faster growth in Japan, which I don't think anybody would dispute, but significantly faster growth in Europe, and certainly a lot of recovery yet to be done in Asia, which could have a very large investment component.

COMMISSIONER LEWIS: What do you see happening in the United States when this occurs?

MR. VOLCKER: Well, let me take the other side first: that they will be demanding more capital, and -- we'd like to see them demanding more capital -- therefore, less money flowing into the United States.

Now, how do you get more savings into the United States comfortably? Part of the reason that we may have as little as we have now, particularly in the personal side, is that everybody feels rich because the stock market is going up so fast. So why do you have to save in the sense that we're deferring savings while you're getting wealthy with your stocks going up?

And if you'll believe that the stock market isn't going to go up forever, maybe that would help the savings rate in the United States. That's a startling

thought to anybody under 35 years old, that the stock market may not go up forever.

(Laughter.)

MR. VOLCKER: But it might be healthy if that notion got around a little more because I think it is, in fact, very hard to stimulate savings when everybody thinks, again, savings in the sense that we're talking about it, when people are savings in a different sense by simply seeing their stock portfolio go up. I think that must be a temporary phenomenon certainly at the rate of speed that it's been going up.

That's not a very good answer, but I --

COMMISSIONER LEWIS: Yeah, but what happens to the American economy if the savings doesn't come here, if Japan needs more money, if other countries need more money, and American consumption goes down? What then happens to the American economy?

MR. VOLCKER: Well, if you saw this nice, smooth adjustment which we would all like to see, you would see the savings rate go up in the United States, consumption go down at least in terms of rate of growth, and the current account make an adjustment that would offset the decline in personal consumption because you were doing more exporting and less importing in relative terms.

And that figure is so big now, a \$420 million gap or something of that order of magnitude. There's a big adjustment that could be made there, and if it was cut in half and nothing else happened, which is, of course, a big assumption, you'd have 200 billion more savings per year. That's quite a lot, and you'd have equivalent reduction in consumption.

Now, you know by what mysterious market process and not completely forecastable market process that would occur is the question. You'd like to see it occur smoothly. You would not like to see it occur, which is the risk, by a sudden financial debacle in the United States or suddenly high interest rates or whatever, which I think would be associated with a decline, rapid decline, in the dollar, and you could get the adjustment rather rapidly. You would get it in the midst of a recession, and maybe a big recession. That's the way you don't want to see it.

CHAIRMAN D'AMATO: Well, Mr. Chairman, on behalf of the Commission we'd like to thank you so much for coming this morning and sharing your thoughts with us.

MR. VOLCKER: Thank you, sir.

CHAIRMAN D'AMATO: It's a privilege to have you with us.

This will conclude the morning session.
We're going to break for lunch and return at 1:30 to
conduct a series of four panels on trade in services.

Thank you all for coming.

(Whereupon, at 12:34 p.m., the meeting was
recessed for lunch, to reconvene at 1:30 p.m.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N (1:42 p.m.)

CHAIRMAN D'AMATO: This afternoon the Commission will take up a series of panels on the United States service sector industries in the global marketplace. The service sector is very important to both the overall U.S. economy and to the U.S. international trade balance. The service sector is represented by 75 percent of the United States GDP and almost a third of U.S. exports of goods and services.

The service's share of U.S. exports is about twice the service share of U.S. imports. So we have a strong net positive balance, and this balance, we hope, will increase steadily as we penetrate world markets.

Therefore, the Commission is interested in the opportunities that access to global markets represent for U.S. service sector industries and the challenges and barriers that U.S. firms face in the world marketplace.

Our first panel this afternoon is on telecommunications and E-commerce services. We have with us Ambassador Thomas Niles, President of the U.S. Council on International Business in New York; George Kohl, the Executive Director of Research from the Communications Workers of America; Dr. Barry Bluestone, a professor at Northeastern University; and representing the Service Employees, a substitute for Andrew Stern, John Howley.

We'll go from left to right, and what we would like to do, as we did this morning, is ask the panelists to summarize their testimony in ten minutes, and there will be a flashing light in front of you. When it goes to amber you've got two minutes to sum up. We'll try to enforce that so we can have some opportunity for the Commissioners to ask you questions.

So without any further ado, can we start with Ambassador Niles?

AMBASSADOR NILES: Thank you very much, Mr. Chairman.

I welcome this opportunity to -

CHAIRMAN D'AMATO: Talk closer to your microphone because the acoustics are not too good here.

AMBASSADOR NILES: Okay. Is that better?
Yes, okay.

COMMISSIONER D'AMATO: Yes.