

For release on delivery
Friday, June 11, 1976
4:00 PM E. D. T.

The World-Wide Problem of Inflation

Address by

Arthur F. Burns

Chairman, Board of Governors of the Federal Reserve System

at the Commencement Exercises of

Florida Institute of Technology

Melbourne, Florida

June 11, 1976

I am pleased to join this audience in a tribute to the members of the graduating class, and also to their parents and teachers who have done so much to make this day possible.

I would like to discuss with you today the dangerous disease of inflation -- which strikes me as the economic equivalent of high blood pressure. The medical profession has recently urged all of us to have our blood pressure checked. High blood pressure damages the human body and threatens the lives of those who suffer from it. Fortunately, when diagnosed promptly, it can usually be treated successfully and brought under control.

I am not a physician, but I do know something about the economic disease of inflation. The effects of inflation are pervasive. Persistent inflation saps the energies of a nation and undermines economic and political institutions. In recent years, inflation has done great damage to the economies of many countries, including our own.

Inflation is a man-made disease. If properly treated, it can be brought under control. All of us -- and especially those of you who are embarking on a new career -- have a vital interest in bringing an end to the forces of inflation.

During your years here at the Institute, you have lived through the worst inflation since World War II. Over the past four years alone, consumer prices in our country have risen by 35 per cent -- an average increase of over 8 per cent a year. Of late, the rise has moderated -- from 12 per cent in 1974 to about half that rate currently. An annual advance of 6 per cent in prices, however, is still very troublesome. If such a rate persisted, the price level would double every 12 years. By 1988, the purchasing power of each of your dollars would be cut in half, and twelve years later -- or by the year 2000 -- your already shrunken dollars would be cut in half once again.

In most other countries, inflation has been proceeding at an appreciably faster pace than in the United States. On the average, consumer prices around the world rose by 15 per cent in 1974, and they were still increasing at a rate of 11 per cent during the past twelve months.

There is nothing inevitable about inflation, as experience in our own and other countries indicates. The over-all level of prices in the United States remained relatively stable from 1952 through 1956, and again from 1960 through 1964. During the latter period, wholesale prices actually declined a little, while

consumer prices increased at an average annual rate of about 1 per cent. There were similar periods of relative price stability in a number of other countries -- including Canada, West Germany, Belgium, Switzerland, and Japan -- during the 1950's and early 1960's.

The disease of inflation will not be cured until an aroused citizenry demands corrective measures. The intellectual leadership that you in this graduating class and your counterparts around the country can provide to the public at large will play a critical role in the success of this endeavor.

Let me therefore describe briefly the characteristics of inflation, the havoc it creates in the economic body, and the course that must be pursued to regain a stable price level and a healthy economy.

The current inflation in our country began in the middle years of the 1960's. The exuberant mood that then emerged in the business community soon gave rise to a series of interrelated and partly overlapping waves of speculation. The first speculative movement involved corporate mergers and acquisitions. Entrepreneurs who displayed special skill in such maneuvers were hailed as financial geniuses -- until their newly-built empires began to

crumble. Many businessmen were so preoccupied with corporate acquisitions that they lost sight of traditional business objectives. The productivity of their businesses suffered, and so too did the nation's productivity.

This speculative merger movement was reinforced, and to a degree made possible, by the speculation that developed during the late 1960's in the market for common stocks. The prices of many stocks shot up with little regard to actual or potential earnings. Speculation in common stocks, moreover, was not confined to the United States. From the late 1960's until about 1973, nearly every major stock exchange in the world experienced a large run-up in share prices, only to be followed by a drastic decline.

The third speculative wave in our country occurred in the real estate market. It involved widespread building of shopping centers, office structures, and recreational facilities, besides land speculation and an extraordinary boom in residential construction. Between January of 1970 and January of 1973, the volume of new housing starts doubled and a huge inventory of unsold homes piled up. Once a condition of overbuilding was recognized, residential construction plunged and for a time virtually came to a halt in some sections of the country.

The real estate boom in the United States also had its parallel in other countries. For example, speculation in land and properties became rampant in the United Kingdom during the early 1970's. And in Germany, the boom in residential construction during 1971-73 led to an enormous increase in unsold housing units -- and to an inevitable downturn in home-building.

It is in the nature of speculative movements to spread from one country or market to another. Just as the speculative wave in real estate was beginning to taper off in 1973, a new wave of speculation got under way -- this time in inventories. It involved massive stocking up of raw materials, machinery, parts, and other supplies in the United States and in other industrial countries. Serious bottlenecks and shortages began to develop in numerous industries. In the resulting environment of scarcities, the rise in prices of industrial commodities quickened both here and abroad.

One of the unfortunate consequences of inflation is that it masks underlying economic realities. As early as the spring of 1973, the trend of consumer buying in this country began to weaken. Many members of the business community, however, paid little attention to this ominous development. Nor did they

recognize that standard accounting practices, which had served well enough in an era of price stability, were now masking the deterioration taking place in business profits. Caught up in the euphoria of inflation, they built up inventories out of all proportion to actual or prospective sales, thus setting the stage for a subsequent sharp decline in production and employment.

The corrosive influence of inflation goes far beyond the distortion of businessmen's perspectives. Inflation erodes the purchasing power of wages. Inflation reduces the real value of the savings deposits, pensions, and life insurance policies of consumers. Inflation creates havoc in financial markets as interest rates are driven up, funds for mortgage lending diminish, and even some large and well-managed industrial firms encounter difficulty in raising funds needed for plant expansion. In short, inflation upsets much of the planning that business firms and households customarily do. The state of confidence deteriorates, and the driving force of economic expansion is blunted.

Concerned as we all are about the economic consequences of inflation, there is even greater reason for concern about its impact on our social and political institutions. We must not risk the social stresses that persistent inflation breeds. Because of

its capricious effects on the income and wealth of a nation's families and businesses, inflation inevitably causes disillusionment and discontent. It robs millions of citizens who in their desire to be self-reliant have set aside funds for the education of their children or their own retirement. It hits many of the poor and elderly especially hard. And it eventually leads to business recession and extensive unemployment, such as we have just experienced to our sorrow.

In recent years, governments have toppled in Argentina, Chile, and other countries -- in large part because the citizens of those countries had lost confidence in the ability of their leaders to cope with the problem of inflation. Among our own people, the distortions, injustices, and hardships wrought by inflation have contributed materially to distrust of government officials and of governmental policies, and even to some loss of confidence in our free enterprise system. Discontent bred by inflation can provoke profoundly disturbing social and political change, as the history of other nations teaches. I do not believe I exaggerate in saying that the ultimate consequence of inflation could well be a significant decline of economic and political freedom for the American people.

Part of the world-wide problem of inflation in recent years is attributable to special factors -- such as the extraordinary rise of OPEC oil prices in 1973, and the crop shortfalls of 1972 and 1974. But the fundamental source of inflation in our country and others has been the lack of discipline in governmental finances.

The current inflation began when our government embarked on a highly expansionist fiscal policy in the middle 1960's. Large tax reductions occurred in 1964 and early 1965 and were immediately followed by an explosion of Federal spending. New and substantial tax reductions occurred again in 1969 and 1971, and they too were followed by massive increases of expenditures. Over the past ten fiscal years, the public debt -- including obligations of the Federal credit agencies -- has risen by nearly \$300 billion.

Deficit spending by the Federal Government can be justified at a time of substantial unemployment. It becomes a source of economic instability, however, when deficits persist in good times as well as bad. Actually, the Federal budget has been in deficit every year but one since 1960. The huge and persistent deficits of the past decade added enormously to aggregate demand for goods and services, but they added little

to our capacity to produce. They have thus been directly responsible for a substantial part of the inflation problem.

It is sometimes contended that the Federal deficits of recent years have been only a minor source of economic or financial instability, since the amounts have usually been small relative to total borrowing by the private sector. This is a faulty argument. We must never confuse the power or responsibility of private citizens with the power or responsibility of government. Business firms and consumers have no way of acting in concert to prevent an inflationary expansion of credit, and their private actions may conflict with national objectives. The basic responsibility for economic stabilization lies with the Federal Government. Unless our government exercises that function better than it has in the past, there will be little hope for restoration of stability in the general price level.

There are some indications, I believe, that our government has of late been taking its fiscal responsibilities more seriously. Thus, the President has recommended a very small increase in budget outlays for the forthcoming fiscal year. Moreover, the Congress has been acting constructively in the exercise of its responsibilities under the Congressional Budget

Act of 1974. There is therefore some reason for hope that total Federal expenditures will not continue to advance at the frightening pace of recent years.

State and local governmental budgets are also receiving closer scrutiny nowadays. The difficulties encountered by New York City have had a tempering influence on the financial practices of States and their political subdivisions -- as well as on those of other economic units -- across our land. The emphasis on sound finance that is now underway enhances the chances of achieving a lasting prosperity in our country. Governments abroad are also more conscious of the need to brake the growth of public expenditures in order to contain the forces of inflation.

Monetary policy too has an important role to play in the fight against inflation, and we at the Federal Reserve are well aware of that fact. We intend to see to it that enough money and credit are available to finance a good rate of economic expansion. But we firmly intend to avoid excesses that would aggravate inflation and create trouble for the future. Many central bankers abroad aspire to a similar course of policy, but some of them are unable to adhere to it because of pressures from their finance

ministers or other governmental bodies. Fortunately, under our scheme of governmental organization, the Federal Reserve can make, and stick to, the hard decisions that are at times avoided by decision-makers subject to the day-to-day pressures of political life.

Prudent fiscal and monetary policies are essential ingredients of a national program to restore general price stability, but they alone may not accomplish that objective within the limits of our national patience. Structural policies are also needed to help restore full employment and to aid in correcting the long-run inflationary bias in our economy.

For example, governmental efforts are long overdue to encourage improvements in productivity through larger investment in modern plant and equipment. A vigorous search should be made for ways to enhance competition among our business enterprises. Governmental policies that affect labor markets should also be reviewed. The Federal minimum wage law is still pricing many teenagers out of the labor market; the Davis-Bacon Act is still escalating costs and prices in the construction industry; and governmental programs for income maintenance now provide benefits on such a generous scale that they may be blunting incentives to work.

In some countries -- for example, Canada, the United Kingdom, the Netherlands -- attempts are being made to hold down wage and price increases through ceilings or guidelines. In the United Kingdom, the government has recently reached an agreement with trade union leaders to grant tax reductions in return for holding wage increases to an average of about 4-1/2 per cent during the year beginning on August 1. Such a policy would involve some decline in real income for workers in the United Kingdom. It offers promise, however, of cutting the inflation rate sharply, and of relieving the downward pressures on the pound in foreign exchange markets.

In our own country, I doubt that arrangements of that kind would be practical. It is clear, however, that restraint on the part of both workers and businesses would be helpful at the present time.

The current economic recovery is now just over a year old. In some sectors of the economy, the advance of prices has already begun to quicken -- even though unemployment remains extensive and a significant part of our industrial plant is still idle. If workers now began to demand large catch-up increases in wage rates or greatly enlarged fringe benefits, or if business

firms began to raise prices faster than costs to increase profit margins, prospects for a gradual further abatement of inflation and a prolonged and stable prosperity would be endangered.

I am confident that we will succeed in curing the disease of inflation if the American people remain alert to the challenge. I hope that members of this graduating class will join with me and other citizens across the country in a national crusade to protect the integrity of the dollar. This objective is within our means and is essential to a future of stable prosperity in our nation.

* * * * *