Remarks by

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Chairman Kelley, distinguished headtable guests, ladies and gentlemen. You've had quite a day, quite a batting order, very prestigious company and a wonderful display of national communications. And now you've got me. My wife asked me to thank you very much for inviting us here for your 35th anniversary. She was particularly glad because it's her 35th anniversary this year. I can't remember whether it's her birthday or wedding anniversary.

Your program of economic education, I know, has been a great success because before I left Providence, we had an example. We had a fellow who lived in the neighborhood, was a ne'er-do-well, and one day he showed up in a great big limousine with a uniformed chauffer, smoking very large cigars and we were quite curious as to how he'd become so affluent so quickly. We inquired. And he said he'd gone into business for himself applying the new economics. He made these little widgets and they cost a dollar, and he sold them for five dollars and he said that 4 percent adds up. Now I'm impressed with your economic education and let's see if we can get the same degree of education into our system for inflation, and for fighting inflation. I'm sure that the President and everyone, every American, would be indebted to you. So I hope you'll be doing that and get that 4 percent back into the interest column.

But I do wa n t to chat with you for a few moments about some serious thoughts. You've asked me to comment on the economy, even though you have many and will have many experts in this field. I'd like to just set a few basic developments before you and then suggest to you that we have some additional challenges in dealing with our economic circumstance, and suggest to you at least one major new area that might be of interest for your attention.

A great deal has happened in the year that I've been here in Washington. The circumstance when I came here was one in which we were emerging from a very deep and distressing recession. The focus was on that recovery. Very quickly, however, it became apparent that there was an accelerating virulent inflation that was going to threaten our economy.

The background of the last decade or so should have taught us a few lessons. We got into the problem of this deeply rooted inflation over some 12 or 14 years. And there's some basic things we did wrong along the way that helped us create this particular difficulty. There's also some things outside of our control that happened in the world that relate to the whole development of technology and the development of industry and commerce and trade. It's a combination of these things that have brought us to this particular time. I think the inflation bias started when we were unable or unwilling to pay for the war in Vietnam and it continued as we went through a series of processes that weakened our economic vitality and left us vulnerable to such dramatic changes as the oil boycott. But the consequence of these particular trends -- and I won't stop to dwell upon them all -- was to leave us with a very deeply imbedded condition of inflation. Not only is the inflation engendered by cyclical forces but it has become more and more structural as its been built into our economy in an attempt to cope with day-to-day conditions, while we have put off some of the fundamental changes that could cure the disease.

The most interesting and rewarding thing to me is that in the past year, there has been a tremendous shift in attitude and response to this challenge of inflation. And in the course of the year, a series of major policy actions and decisions have been taken, and we have put in place a number of powerful weapons that are being marshalled to wage a sustained war against inflation. I just want to tick off those policies and then look ahead to the future, to where we're going and where it is we need to complete the marshalling of the arsenal of weapons to fight inflation.

The first major change last year was the recognition that resurging inflation required change in our economic strategy. There was a very courageous shift in fiscal policy, so that fiscal policy that had been directed toward stimulating the economy to bring us out of deep recession was shifted toward a mode of restraint. This was done quickly, once it was perceived that inflation had become the real threat to the welfare of the American system. I think the President and the Congress should be commended for their willingness to make this shift, both in terms of speed of the new policy direction and the degree to which they redirected their policy. We have no precedent in history where there has been a $22 billion cut in a financial plan within months of its being proposed because of new threats. And it took considerable courage, I think, to be willing to make that shift.

A second major policy that's been put in place in this period is an incomes policy, dealing with wage and price standards asking for voluntary compliance with a program of restraint and moderation, so that we could buy time to have the fundamental shifts in policy begin to take hold and begin to help us squeeze out these inflationary forces. That incomes policy has been a subject of a good deal of discussion, a good deal of controversy. But if you look at it, perhaps as I do as an outsider who has not been involved in it, my own assessment is that it has resulted in considerably lower rates of increase in price and in wage commitments than would have taken place without that voluntary effort.

I know that major corporations are complying on the one side and I think in all some 20-odd major labor contracts have been signed since last October, and I think all but two are clearly in compliance. So I think a great deal has been gained by having this example of cooperation.

A third important policy direction had to do with our international accounts. In 1978, the dollar was under pressure for most of the year. Your daily headlines and your daily reports on your newscasts told of a weak dollar, a declining dollar, a chaotic market. That decline is somewhat academic to many Americans. They don't appreciate the impact that these particular market conditions have in their daily lives. But the truth is that the decline of the dollar over that period added one percent to the inflation rate last year because of the higher prices we had to pay for the essential imports to make our economy go. Now, one percent inflation last year was the equivalent of a $15 billion tax on consumers. And because of the ripple effect of these prices working through the system, we have one more percent to go. And so we have another $15 billion tax this year as a result of the decline of the dollar. And so it was particularly important that the government moved forcefully on November 1. The President announced new vigorous fiscal measures; the Federal Reserve took monetary action; and in cooperation with the governments of Germany, Switzerland and Japan, we marshalled $30 billion of resources to ensure that we would have an orderly market and a stable one. That has been an effective and successful program which has cost us nothing except our will and determination to do it. That has provided us the opportunity in 1980 and thereafter to avoid the inflationary impacts that we have been suffering. So that's an important powerful weapon in the war against inflation.

In addition, there have been a number of important new policy directions in the energy field. It's critical that this nation reduce its dependence on petroleum as an energy source and that it reduce its dependence upon imported petroleum. These steps are hard to carry out in a heterogeneous nation with many regional differences. It is very difficult but slowly the pieces have been falling into place. You did have major energy legislation last fall and the President is now taking steps to decontrol domestic crude. That will start the process of not only creating conditions that will contribute toward conservation, but conditions that will contribute toward greater supply and the incentive to shift to alternate indigenous sources of energy. So this is an important part of the array of weapons that fits into the pattern of the anti-inflation program.

And I couldn't resist the opportunity to remind you that monetary policy is another one of the powerful weapons that fits into this same array. During this period of time, monetary policy has been directed -- and fortunately for the good for the country -- in confluence with the policies of the administration toward the same fundamental strategy, the same fundamental purpose. Monetary policy during this period has been in a restraining mode. It has been endeavoring to arrest the rate of increase in money and credit in order to dampen demand and dampen inflationary forces. The tactical aspects of monetary policy have been intended to reduce deliberately the rate of growth of the economy so that it would come to a more sustainable level and avoid the overheating that could carry us into regimes of utilization which are beyond our economic capacity and, therefore, lead to demand-pull inflation. So we can apply monetary restraint for the purpose, consciously, of bringing the economy to a slower rate of growth, consistent with fiscal policy, consistent with the other policies.

Secondly, we have been endeavoring to do this on a consistent staying path, avoiding shocks and disruptions and making it easier for individuals and businesses to plan the adjustment to this economic pattern.

Thirdly, we have been endeavoring to accomplish this while maintaining balance in the economy so that the burden doesn't fall too heavily or too unfairly on any one sector. It's for that reason that we authorized the money market certificates that avoided disintermediation and allowed the housing industry to compete for funds and to stay in business instead of going out of business as it did in '73, '74.

Finally, in monetary policy, we've been endeavoring to accomplish this without throwing the economy into a serious tailspin, into a serious recession. Such a recession would automatically result in increased Federal deficits, would automatically result in pressures for additional Federal spending and would automatically result in increased bias toward inflation which would start us off on a new treadmill and a new cycle the next time around.

All of these policies are consistent with a pattern of reducing somewhat the role of the Federal government in our economy, of returning more of the action to the private sector, and creating conditions where over several years it will be possible through later tax reductions -- once the budget is balanced -- to return spending and investing decisions more to the private sector where their influence on progress will be more efficient and more effective than the same effort through government channels. These are important measures of policy direction and they do fit into a consistent cohesive strategy to deal with the problem that has been built up for a dozen years and is deeply imbedded in our system.

And because of that deep character of inflation, deeply rooted, it means that these new policies, effective and powerful as they are, as they address the fundamentals rather than the superficial aspects, will all need several years to work through the system and unwind the process which is building up and has its own momentum. It will test the will and the patience, the determination and the character of the American people to see if we will stick with policies that are sound and will continue on a course that will bring us back to achieving our economic goals which clearly have the unanimous objective of achieving full employment, price stability and a sound dollar.

There's one additional important policy decision that needs to be put in place. Quite often as we talk economic policy in this country, we talk about this week or this month. We get up tight about the figures that we read right now. We sometimes forget that our actions today in many of these basic economic areas don't have an effect until six or so months downstream and sometimes we forget to begin to plan the policies that are consistent with the plan of the economy we would like to see achieved. I'd like to just suggest to you a plan that to me would make sense for the economy. It would make sense for us to see the economy slow from its over-extended condition, gradually reducing its rate of activity through 1979, probably coming down to only a 1-1½ percent growth rate toward the end of the year in real terms, and thus beginning to relieve the pressures on capacity, giving us enough slack in the economy to catch our breath and prepare for a more moderate and more sustained growth rate, avoiding the high amplitude cycles of boom and bust that have caused so much distress to us in the past. And the other part of the plan we need to implement is to bring ourselves out of that adjustment process, not with further stimulus for consumer demand but with further stimulus for investment. And the challenge we face, it seems to me, is an investment challenge. Let me cite you some of the reasons.

For the first twenty years after World War II, the United States led the world in productivity gains. Each and every year, we averaged about 3-1/3 percent higher productivity. And that productivity gain provided us a basis for annual increases in the real income of every American. That was for 20 years. For the last ten years, our productivity gains have been only 2 percent and for the last five years, only one percent. No wonder we're falling behind the rest of the world. No wonder our products and services are not as competitive as they once were.

There are some fundamental reasons for our falling behind. In the first place, our capital spending has been lagging. It's been deficient. Its more than a cyclical deficiency. It's just not the ups and downs of the business cycles but there's been an underlying slackening in our commitment of investment for some time. Since the late '60's, we've been under-investing in the production of basic materials and that's why we often have shortages, and that's why right now people are worried about the possibility of runaway inflation, because of a shortage of materials. Replacement needs of an older, more extended economy have taken up more of our capital. These are necessary but capital-intensive environmental safety investments have also drawn resources away from the net investment that we need to make. And the growth in the capital stock as a result of this has been far lower in net terms than we've seen in the past and we have not yet even come back to the peak of investment that we had at the height of the last business cycle.

Five years ago, we were spending more on investment than we are now. The result of all this is that our capital has grown more slowly than our labor force and so we are beginning to fall behind in putting in place the investments that are essential if we are to provide the jobs for the future. And we're falling behind other countries: Japan spends more than 20 percent of its gross national product on capital investments; Germany, 15 percent of its gross national product, the United States, 8 or 9 percent. Decade after decade, if we continue on that path, we're headed surely as can be to being a second class technical industrial nation, and we cannot afford that. And so my proposition is that we should start thinking now, soliciting your support and understanding now, so that in 1980 we can put in place this powerful policy weapon of investment to bring us back in the next growth pattern, to lead us with supply and productivity vehicles ahead of the demand for final products so that we can adjust this process between capacity, supply and demand. And if we lead ourselves out, we can once again re-establish ourselves as the leading, most efficient producer in the world.

My proposal is that we all endorse a simple formula and you don't even have to write it down. You can remember it. It's not a complex economic proposal. It is three simple numbers. 1-5-10. 1-5-10.

1-5-10 stands for a new policy of liberalized depreciation in which all mandated investments for environment, safety and health would be written off in one year. All new investments for productive equipment would be written off in 5 years, and all the capital in structures and permanent facilities would be written off in 10. For those of you who are not familiar with the process of investment, this means that for the business people who are here -- thinking of their risks, future costs and future prices -- they suddenly have a formula that reduces their risk and gives them every incentive to modernize their facilities to expand their capacity. The result of this would be to reduce the unit cost of production, to reduce the units of energy required for output, to improve our technology, to improve our competitiveness in the world, and to break the cycle of wages chasing prices and prices chasing wages.

So I don't come here tonight to lecture you on the current scene and what we should all be doing in these nervous days, but to tell you we should all be thinking now and we should be trying to bring together the dynamics of this or some other similar plan that would put this nation back on the track to its world leadership as an industrial nation, the economic force that it must have if it is to achieve its other aspirations. Thank you very much.

QUESTIONS AND ANSWERS

QUESTION: Does anyone else know about 1-5-10?

CHAIRMAN MILLER: For about a month now I've been unveiling it in every speech I make on the theory that if enough hear about it somebody will pick it up as a cause and maybe it will become a groundswell to move in this direction. After a long period of technological leadership and for a number of reasons which are understandable, we have come to prefer consumption to investment and that's good for the good life. But like anything else, if you always take out and never put back, you're bound to leave for your heirs and your successors a very, very desolate condition. If we don't begin to realize the limits of our ability to live off the land without putting back, then we certainly shall suffer as a nation. And, I think it's time we address this problem. Are there other questions?

QUESTION: I assume that if you were to depreciate an investment over a year's period of time, you would pass those costs through and I don't quite follow what that would do to inflation.

CHAIRMAN MILLER: In cost accounting, what you normally do is depreciate by costing your product over its useful life. Most corporations will do this by getting cash flow from the tax write-off. Then for costing their product, they would assume the life of the investment, otherwise it would not be competitive. Most companies now have different depreciation rates for tax purposes. I might add that this is not a very attractive way to do it from the point of view of the Treasury of the United States.... If you give an investment tax credit that's a forever forgiveness of taxes. You never can get it back. But if you give a tax depreciation the government just collects it a little later.

QUESTION What are the mechanical requirements to implement this plan?

CHAIRMAN MILLER: Just a simple law through Congress. It doesn't take many words, it takes a striking out of a few things and putting in a few extra words. Very simple, I'm sure it could be drafted within 24 hours.

QUESTION: (Inaudible)

CHAIRMAN MILLER: Yes, the passing is what I'm trying to work on now. Let me say one final thing. This is an amazingly great country. Imagine the shocks that we suffered in the last fifteen years and imagine the resilience of this nation to take those shocks and to maintain its political strength, its social strength, its economic strength. There's been too much cynicism in this country recently, too many people who have come to distrust themselves and their fellow citizens.

It seems to me that one of the things we need to come out of our economic doldrums is to relook at the basic strength, that resilience, and to gain from it a bit of self confidence and once again believe in ourselves and believe in each other and be willing to work together, rather than to be divided. And if we do that, I'm sure that we certainly shall win the war against inflation and we shall win the war of restoring this nation to its inherent strength in everything.

Now I'm going to pass to these gentlemen a football that has 1-5-10 written on it. You now have the ball, I hope you will run with it.