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HAVE WE LEARNED FROM OUR MISTAKES?

Remarks of

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Have We Learned From Our Mistakes?

Over the past year the United States has witnessed another of the repetitive postwar business cycle turning points from inflation to recession. Both the inflation and the recession have been stronger than at any time in the past 40 years. This repeated pattern reflects imbalances, instabilities, and uncertainties created partly by the inherent free choice nature of our society and partly the public policy mistakes of politicians, economists, businessmen and labor leaders. Since most of us prefer to keep the free enterprise capitalistic economy, we must look to the correction of policy mistakes or at least learn from them and avoid repeating them.

Today I want to catalogue and briefly discuss six primary areas of public policy or attitudes which I think have had an important bearing upon the repetitive business cycles of the postwar period. First, as a nation we have failed to recognize the persistent debilitating effects of inflation both as a disrupter of economic progress and as the greatest tax on all our people. Public policy has just not placed the requisite high priority on this problem. Time and time again our nation has taken actions which clearly had inflationary consequences without parallel actions to offset those effects.

Secondly, our people fail to understand the price features of interest rates and have failed to recognize that long-term interest rates reflect both demand and supply of credit as well as the expectation of inflation. Perhaps the best recent example of this has been the House of Representatives' resolution calling for Federal Reserve action to lower long-term interest rates. We could flood the market with new bank reserves but this would just force a large decline in short-term rates and a temporary small decline in long-term rates. If, as one would expect, the investors viewed such action by the Federal Reserve as a long-run inflationary move, we should expect long-term rates to rise as investors demand an even higher inflation premium.

Thirdly, in recent years, the monetarists have demanded a steady growth of money supply and have so conditioned the politicians, Congress, and even the large banks to this theory that they are demanding Federal Reserve policy based exclusively on this one policy target. It is difficult to speak without emotion on this will-o-the-wisp, statistical myth, which represents the miracle seeking of our professional economists and politicians. Those who have worked at monetary policy know of the difficulties of reaching a single targeted policy, especially one grounded upon theoretical desires, rather than the practical world of our complex ever-changing economic environment. The narrowly-defined money supply may have policy relevance in a long-term model with two-year targets but even then it must be broadened to include the rapidly developing near-money use of time and savings accounts, certificates of deposits, commercial paper and loan participations. Our people have become interest-sensitive and are holding large blocks of spare cash in interest-bearing accounts, which can be converted on a moment's notice to transactions balances. In effect, as individuals, they are following by more than five years, the persistent move of large corporations which have been managing their cash balances in a steadily more interest-conscious way.

The money supply advocates similarly fail to recognize the impact of the large and volatile foreign balances which move in and out of our banking system. Since such balances count toward the money supply, their extreme shifts necessarily complicate any attempt to meet a particular target.

But the primary difficulty I have with the monetarist approach is their blind allegiance to a single target. Life just is not constructed in such a simple fashion. The problems with Penn Central, Franklin National, the tenuous character of an illiquid banking system, and now the prospectively massive budget deficit financing, all militate against a single-minded approach to monetary policy. The Federal Reserve has modified its monetary aggregate objectives because of these and because of the trends in money market conditions, especially short-term interest rates. The monetarists counsel a hands-off-policy on such matters, particularly interest rates, but it is difficult to see how our central bank can ignore them when interest-sensitive funds move with such rapidity between nations and we must pay attention to the international position of the dollar.

Fourth, the international problems of our nation have failed to receive adequate attention from either the public or private sectors. While the charge of benign neglect has been excessively harsh of late we still permit further growth of the large overhang of dollars abroad; we permitted our nation to become dependent on foreign sources of many basic raw materials; and we tolerated continuous balance of payments deficits and a volatile unstable exchange rate. While there are limits to which public policy can restrain international outflows, without self-defeating credit or exchange controls, we have not attacked the fundamental causes of the outflows nor even kept the balance of relative interest rates sufficiently in mind. Of course, the fundamental problems have been the use of the dollar as the vehicle and reserve currency of the free world and the outflows for military endeavors as well as grants and loans.

Fifth, and crucial to our problems of yesterday and today, has been our failure to come to grips with the rising government expenditures and budget deficits. Not only has government responded to the welfare and protection demands of the population, but has provided a steadily widening array of new services. These, coupled with the pressures of inflation and rising wage costs, have enlarged government expenditure levels at an accelerating rate. Even more unfortunate though, government has not been willing to raise revenues to pay for the higher spending and therefore deficits have increased. Congress seems to have just one remedy for any problem, especially economic downturns, and that remedy is increased spending.

The sixth mistake has been to permit and in places even encourage corporate or union monopoly powers. With such power businessmen and union leaders have raised prices and wages at rates which bear little resemblance to the normal changes elsewhere. Such disruptive policies coupled with the lack of competitive discipline have contributed to the cyclical pressures on our economy.

I recognize that you have a strong interest in the future of our economy, for sometime soon you may escape these hallowed walls. But then you face the economic realities of obtaining a job. Hopefully, you will have so trained and educated yourselves that you will offer a prospective employer a mutually profitable arrangement. Hopefully, also, our economy will be in an ascending mode, generating new jobs in the many diverse fields in which you seek employment.

We also are vitally interested in economic recovery and progress and we hope to achieve them without committing the same mistakes of past periods. Thus we hope that Congress will act promptly to pass a tax cut and incentive tax investment bill which can be implemented promptly. We also hope that Congress will be sparing in its budget approvals of other bills to hold down the deficit. For monetary policy, we need cautious expansion of reserves to provide a balanced credit base upon which the future expansion will be established. Business and labor need to get together to reach a conservative position on wages and prices over the coming months. With luck abroad and favorable actions on the above-mentioned policies at home, we can look toward a sustained recovery with an equilibrium base for expansion including low rates of inflation and improving employment prospects.

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