FOR RELEASE ON DELIVERY
TUESDAY, FEBRUARY 24, 1976
11:00 a.m. C.S.T.
(12:00 noon E.S.T.)

A BLUEPRINT FOR THE DEVELOPMENT OF THE UNITED STATES ECONOMY

Remarks of

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Dallas, Texas
February 24, 1976

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The prior speakers have covered a wide variety of topics at this conference, including energy, labor, world trade, and many aspects of the United States economy as related to those items. My assignment is the U.S. economy as a domestic matter and with some comments on the international. By the very title of the subject, I suspect that the organizers of this conference expected me to present an outline of the United States economy for the year ahead and the pitfalls which might threaten the forecasted posture.

First, economic recovery is under way in the United States. It has been supported by near completion of inventory liquidation and is being supported to some extent by a modest accumulation in certain lines. It is further supported by growth in private housing starts and heavy Federal Government expenditures. Increased industrial production--up more than 8-1/2 percent over the low of the spring of 1975--has also been a product of this recovery. But the recovery over the past six months and in fact for the entire recovery period has rested heavily upon increased consumer spending. You will recall that about a year ago there were tax refunds to 1974 taxes in the amount of nearly $26 billion and, on top of this, Congress added special payments to Social Security recipients and special tax rebates as stimulants to recovery.

These payments from the Treasury to the consumer had a marked effect upon consumer spending in the spring of 1975. In fact, their stimulus did not weaken until mid-summer when the majority had either used the rebates or placed them into time deposits or investments. Since that time consumer spending has strengthened on the basis of rising employment levels, increased wages and hours worked, and a considerably better tone of consumer confidence which has emerged especially since the start of 1976.

But the recovery has not been completely balanced or uniform for all sectors of the United States economy and has been dampened by a number of elements. First, there has been a slow rate of capital spending. Businessmen apparently feel that with the rate of utilization of capacity in the low eighties, there was no urgency to build new capacity or expand new equipment. In fact, a sizable part of the recent capital spending seems to have been directed toward meeting air and water pollution standards. Only in a very limited number of industries, especially natural gas, oil, and other extractive industries, was there any major increase in capital for new capacity. The slow rate of capital spending is reflected in the most recent Department of Commerce survey which showed plans for only a 4-1/2 percent increase in nominal terms for 1976.

Since recoveries from recession in the United States economy have normally been extended only if capital spending also joins the parade, we might diverge for a moment to see what could be done to improve capital spending in the year ahead.

As I view the future for business capital spending in new plant and equipment for 1976, there are two critical factors which must be resolved. First, businessmen must be convinced that the recovery is to continue and that consumer expenditures will be further enlarged so that there will be a market for the products of an enlarged capacity. Second, businessmen must be convinced that their profit ratios will be strong enough to support new debt for capital spending before the new equipment comes on stream. In other words, the bottom line must show a sufficient profit to constitute a reasonable return on investment before businessmen will spend for new capacity. There are some favorable signs with regard to capital spending, particularly the improvement in corporate liquidity--the corporate ability to fund bank debt and renew their bank lines of credit and the improved cash flow of corporations which has developed over the past few months as spending and consumption improved. In addition, new capital spending for some specialized industries appears to be increasing. Long-term rates of interest have come down marginally over the past sixty to ninety days and this should provide an atmosphere of improvement for business capital spending. But given the long-range nature of such spending, I suspect that businessmen are considering such factors as the degree to which Government may crowd the capital market by heavy Government financing issues and the degree to which Government may impose further environmental capital requirements. There may even be some lingering suspicion that Congress may decide to allocate credit by high priority measures through the Federal Government's own spending. But none of us have a perfectly clear crystal ball and we must act on available knowledge and that information today signals a lessening of Government deficit spending, no return to price controls, and improved capital spending incentives through possible increased investment tax credits and improved profits.

The recovery also has been dampened by the progressive rate of income taxation and the increased taxation of State and local Governments, taxes which have risen sharply over the past two years. Heavy taxation has slowed what could have been an even sharper rate of consumer spending and probably has taken its toll in some of the dampening of capital spending plans.

Similarly, the recovery has been hampered by slow land development activities and slow multi-family and office construction. It is easy to understand these slow areas because of the problems which have developed in the real estate industry and particularly the multi-family condominiums and apartments over the past few years. It is not likely that this pattern will be reversed in the near-term and thus land development and multi-family construction will probably not provide support to the economy for 1976. However, single family construction is improving and commitments are rising sharply.

Nevertheless, the balance of the pros and cons of the economy today still impresses me as having a prospect of growth with possibilities of moderation but increasing chances of more rapid expansion. The nation's mood of recovery is gaining confidence, thus diminishing the chance of aborting the recovery. Instead our problems are likely to be in the field of a more rapid rate of expansion than prior expectations. You will understand, of course, that I cannot be more specific with regard to monetary policy prospects nor should I be expected to spell out what I think interest rate developments will be since the policies on which I must vote have an important bearing on these matters. Nevertheless, looking over the broad stream of economic life in the United States, one can come up with only a very few important economic limitations on a more rapid rate of recovery and these can be cited primarily in the field of capital spending, taxation, land development and multi-family construction and the dampening effect on State and local government spending from the problems of New York State and New York City.

Perhaps it would be well if I stopped here because I have given you the picture as I see it for the coming year. But you have asked me for a blueprint and blueprints require a more specific isolation of problems and potential solutions to those problems. Therefore, I intend to pursue this to some degree, isolating some of the principal uncertainties facing the United States as well as some of the potential remedies to those uncertainties. In the field of economics it seems to me the principal uncertainties lie in the problem of restimulating capital spending. This can be done, of course, by providing greater certainty in the field of prospective capital returns and profits, by stabilizing the effects of future wage increases and inflationary problems and by demonstrating the need for that new capacity at levels which would be sufficient to justify construction. The overhang of apartments, condominiums and office buildings is a problem which is likely to be resolved only with sufficient time to complete many of those projects and allow the demand for space to absorb present vacancies.

The relative rates of growth in the United States versus other countries will have an important bearing upon the rate of exchange of the United States dollar. As other countries expand, they become better markets for our goods and, if we expand more rapidly then they do, our people become major importers, thus shifting the balance of trade and causing an outflow of funds. Exchange rate instabilities can cause some disruption and problems in international markets, but the prospect for greater instability does not seem markedly different today than in the past.

Perhaps one of the greatest uncertainties though, both at home and abroad, is the question of the degree of inflation. It is pointless to review the history of inflation except to learn from the causes or to point out the double-digit levels of 1974 or the decline in those levels in 1975. Our concern is with the future. If external pressures can be kept under reasonable control and if food shortages do not create sudden and unexpected adverse effects, the primary question on inflationary pressures within the United States must be the rate of wage increases. The year 1976 will be one in which there are major union contracts coming up for renegotiation. If the wage and benefit increases from such negotiations can be kept at or below the pace in 1975, then the United States has an excellent opportunity to develop a broadly based and relatively balanced recovery with lower inflationary pressures and a return to high-level resource utilization.

Such a prognosis, however, must be qualified according to the changing picture of Government finance. Among the primary financing uncertainties of the year ahead must be the rate of budget stimulus or deficit. The President's budget for fiscal year 1977 shows expenses advancing $20 billion to a level of $394 billion, while revenues are expected to increase by $53 billion to a level of $351 billion. The expected budget deficit is $43 billion for the coming year. Expenses are expected to rise only for income security, national defense, and interest payments. All other Government expenditure elements are expected to show a reduction in 1977. Revenue gains are expected from the higher level of economic activity, offset to some extent by a $28 billion cut in taxes. If one views this budget in light of the inflation, it is clear that the real dollars to be spent by the Federal Government for 1977, according to the President, would be reduced by 3 percent. Whether the President actually realizes his expectations with regard to the budget will, of course, depend heavily upon Congressional handling of expenditure and tax legislation over the coming nine months. If Congress views this year as one in which further stimulation by Government spending is not necessary, it may accede to the President's budget, and if Congress strictly adheres to its own budget reform act, there are some elements of optimism that our heavy Government expenditure advances may be dampened.

Another major financing question for the nation in this coming year must be that of commercial bank policy. Clearly, over the past two years, banks have had to contend with major losses stemming in a large part from the recession and its impact upon real estate developments and in part on other corporate failures. Bankers responded to these losses by tightening their lending terms and limiting their growth of assets. Over the past few months, disclosures of certain banks on special surveillance lists and Congressional demands for additional information have impacted upon bankers' psychology to an unknown degree. Congress is at the moment studying the financial institutions of this country, trying to develop new legislation for restructuring our financial industry and its regulators. Some appear to view the published problems of some of the banks in the United States as a reflection of a poor job of regulation whereas from our standpoint the fact that there is a list of banks requiring special surveillance is evidence that we have been watching the banks with a great deal of care and have put special surveillance elements into our regulatory and supervisory work.

Banking is a risk industry. Unless bankers take risks, they cannot support their communities nor the industries and businesses making up those communities. Bankers expect to have some losses. Losses may result from poor management, from adverse economic conditions, from errors by consumers and businessmen, and from errors on the part of bankers in appraising those risks. But if risk taking is to be eliminated in the banking industry, banks will no longer serve the nation and the nation's economic recovery would be less than assured. In fact, an abortion of the recovery would be possible. It is for these reasons that I have been appalled at the idea of publishing the lists of banks under special surveillance or the lists of classified loans. I believe that no public interest purpose would be served by such publication since the public cannot appraise the specialized work of examiners and since the efforts to improve banks and get them back on to a solid footing would be hampered by such public releases. It is my position that we do not seek to keep information confidential for its own sake, but instead, for purposes of insuring that the institution returns to sound banking practices for the protection of the depositors of the bank.

Tax policy is also a major question in the financial arena for 1976. Investment tax incentives are a possibility but given the recent disclosures concerning foreign payments by major corporations in the United States, investment incentives or profit improvement through taxation may have been jeopardized. Tax policy also is important to the pricing policies of the Federal establishment. If taxes are to be levied to achieve a pricing result, Federal tax laws will become more important instruments of economic policy. Tax policies also will affect Federal and State relationships. If Federal revenue sharing to State and local entities were diminished, some sources of taxation would need to be turned back to the State and local entities for their use.

Finally, we should mention monetary policy as one of the uncertainties of the coming year. You can be assured that monetary policy will be reactive to the deficits of Federal Government financing. In reality, we have little choice because when the Federal Government creates a major deficit and finances that deficit in the market, there must be some accommodation by the central bank or the financing issues would fail. Monetary policy also will react to commercial bank lending patterns. If the demand for bank credit by business were to continue as slow in 1976 as it was in 1975, you could expect one reaction by the central bank, whereas, if business borrowing moves up sharply, another eventual reaction could be reflected in monetary policy. Monetary policy must also be reactive to bank lending terms and conditions, for the central bank will need to try to foster confidence in both borrowers and lenders and improve bank lending attitudes. One must admit quickly that monetary policy can do very little toward changing the attitudes of people, except tangentially through its basic policy moves. Finally, monetary policy will have to be reactive to the international scene. If exchange rates become more stable or if improved and coordinated central bank intervention can achieve greater stability, then the monetary policy can obviously be less concerned with the international changes. But if exchange rates and the international balance of payments relationships of the United States are adverse in the coming months, there could be implications for monetary policies with possible action to offset some of these difficulties.

Well, I have reviewed with you the possibilities of the growth of the economy for 1976, and the items which seem to me to be hampering or potentially interfering with the recovery. But perhaps I have not been clear enough so here is my blueprint for a better U.S. economy in 1976. In my opinion, we need the following actions:

First, a tax reform measure to stimulate business investment.

Secondly, legislation just extending the tax reductions of the past six to twelve months into the remaining part of 1976; any further reductions should be matched by spending cuts.

Third, a parsimonious budget and expenditure level for the Federal Government with a blueprint of reduced Government spending wherever possible and declining employment ceilings on the Federal establishment.

Fourth, Congress should support the reduction in the Government spending, with a clear and impenetrable ceiling, and at the same time, establish as quickly as possible its tax reform proposals so that the uncertainty can be eliminated.

Fifth, we the American people, our elected representatives, and the media, should give up this mania of introspection by excessive publicity and disclosure. Harm which can be done by such disclosure is such that private, personal or corporate competitive data may be released, and we could hamper our relationships with buyers and sellers abroad, interfere with the normal patterns of trade, and disturb the normal, historical export programs of this country in technological goods.

Sixth, I think it would be most helpful if the United States and other principal industrial nations abroad were to fully implement the Jamaica Agreement to bring greater stability to the exchange rates through intervention and through more closely coordinated monetary and fiscal policies on an international scale.

Obviously, this blueprint will not guarantee recovery, prosperity, or a lasting improvement in the national wellbeing. But failure to move in the directions outlined will certainly hamper recovery and could mean a slower than necessary pace of recovery for the United States economy, and therefore, a lower rate of utilization of human and material resources in this nation.

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