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ARE WE REALLY SERIOUS ABOUT REDUCING INFLATION?

Remarks of

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ARE WE REALLY SERIOUS ABOUT REDUCING INFLATION?

Over the past ten years the United States has seen a growing inflationary threat which materialized in the 1974-1975 period to a double digit rate. From the trough of that inflation induced recession to the present, the inflation rate has grown and is again approaching dangerous levels. Millions of us are once more naming inflation as the primary United States problem and promises of vigorous action to contain this growing threat have been made by numerous officials.

But are we really serious about reducing inflation? Or are we in the United States becoming accustomed to inflation and setting our personal and business decisions based on expectations of a double digit inflation environment? Are the statements of our leaders really to be taken at face value or are their actions contradicting what they are saying in the anti-inflationary war? Are the actions of the United States in keeping with a nation dedicated to reducing inflation? Doubts are again creeping into the minds of many Americans as to the seriousness and dedication of our Government leaders toward eliminating the inflationary threat. Too often we have been told that a new anti-inflation program is just over the horizon which will have important actions geared to reducing inflation even though only gradually. Too often these statements are not followed through with concrete actions nor actions credible in the world community.

The United States has come a long way since World War II and has made as much progress as virtually any other nation in building the standard of living of its citizens. Since the trough of the recession in the first quarter of 1975, we have seen major growth in gross national product, industrial production, housing, consumption, and employment. We have reduced the unemployment rate from 9 to 6 percent, we have kept housing starts growing at nearly a two million annual rate, and industrial production has advanced more than 20 percent in the past three years.

On the other hand, our level of capital spending has been inadequate and consequently our capacity for further expansion has not kept pace with the rate of output in the U.S. economy. Also, inflation has grown over the past year or two and the exchange rate of the dollar has deteriorated badly. Today we are reaching nearly full capacity use in some manufacturing and raw material outputs. In other areas we are approaching effective capacity, as some plants are inefficient or incapable of operating at the level of rated capacity. Similarly, our skilled employment force is nearing capacity. A major compositional shift bringing more women and teenagers into the labor force has permitted employment increases of nearly 9 million workers since early 1975, while unemployment is still more than 6 million.

Since the beginning of 1978 gross national product has risen almost $150 billion on an annual rate, total personal income is up $100 billion and gross private domestic investment has grown more than 10 percent. The U.S. labor force has increased almost 2 million people in the first 9 months of 1978 and total civilian employment has advanced by more than that number. Industrial production has risen more than 6 percent from January to September with the largest gains occurring in durable manufacturing and mining, and new housing starts have remained strong. Personal consumption expenditures have advanced at an annual rate of more than $100 billion since the first of 1978, and retail sales at the major department stores are running around 11 percent above the level of a year earlier. A major resurgence in automobile sales has occurred in the second and third quarters of 1978 and people are buying new household furniture and equipment at a rapid pace.

But a heavy share of the dollar denominated gains are a result of the higher rate of inflation. Consumer prices by August had already risen over 5 percent. To finance a large share of their purchases, consumers incurred a heavy load of new debt. Since the first of the year nearly $3 billion has been added to outstanding consumer debt. Similarly since the first of the year the dollar has depreciated by more than 12 percent against the currencies of our major trading partners and against the Japanese yen, and the Swiss franc, the depreciation has reached more than 20 percent.

Against this background our Government leaders began in the spring of 1978 to advocate stronger anti-inflation policies for the United States. Unfortunately, with the exception of the major move of the Federal Reserve toward credit restraint, little has been accomplished. One might be forgiven if he wondered whether inflation has not indeed become such a way of life that fundamental U.S. policy is one of accommodation, not containment and certainly not reversal.

It is unnecessary to detail for you all the evils, inequities, and distortions of inflation. You know them well. You know that the individual on a fixed income, a retired person or even a wage earner who fails to get an increase sufficient to compensate for the rate of inflation is losing purchasing power each year. It also seems unnecessary to review the track record of inflation other than to say that presently the rate exceeds 7 percent contrasted to 6 percent a year ago and that the pace of inflation has moved to the point of creating expectations of even higher rates. Instead I wish to revisit some of the Government actions of the past year to see if inflation is really being treated as our number one problem. In other words, let us compare the actions and statements of the Government.

For many months the inflation rate has been a front page topic for the media, and Congress and the Administration have had ample opportunity to measure the effects of their policies and actions. To their credit, progress has been made in reducing the rate of growth of Federal Government spending and the projected deficit has been cut sharply from the $60 billion initially projected for fiscal year 1979 to less than $40 billion presently projected. But the deficit was excessive at this stage of the business cycle and even larger cuts were warranted. Instead Congress has passed spending bills and a large tax cut and has continued to support some of the principal impediments to capacity expansion. Moreover, it failed to take action to remove or mitigate some of the primary stimulants to inflation.

The budget process indeed reduced the Government stimulus of deficit spending, but Congress and the Administration left intact the increases in minimum wages, social security taxes and also the inflationary costs and delaying impacts of excessive environmental and other regulatory impediments. The costs of meeting the heavy load of reporting and monitoring compliance for such regulatory legislation as OSHA, Equal Credit Opportunity and Truth in Lending, were areas where a government truly dedicated to anti-inflationary programs could have made a significant contribution. Instead, it permitted these and the new Community Reinvestment Act to remain on the books continuing to burden industry and financial organizations with their costs.

If Congress as a whole made only its budget reduction action to the anti-inflationary fight, it made at least some contribution. However, both Congress and the Administration seem insistent upon such things as a tax cut which will spur consumer spending at a time when such spending has been a primary force for expansion and, through purchases of imports, was a major element in our balance of trade deficit. A sincere effort to fight inflation would suggest no personal tax cut but a larger spending cut.

The above failures to center upon the anti-inflationary needs of the nation are significant but so is the continued carping of certain Congressional and Administration spokesmen about the restraining efforts of the Federal Reserve. One gets the impression from the criticism of Home Loan Bank Board spokesmen that the Federal Reserve should validate the current level of inflation by providing more reserves regardless of the inflation for fear that housing starts might decline. They apparently fail to comprehend the large inflation-induced increases in housing costs and the debilitating effects of such costs in narrowing the effective buyer groups and raising the amount to be financed. There is indeed a curious dichotomy of criticism among Congressmen, academics and government spokesmen. Some groups insist that monetary policy be set by a mechanistic computer policy of money supply growth, ignoring the current developments of the economy. Some advocate this line of policy in order to neutralize discretionary actions of the Federal Reserve and force it to ignore both interest rate changes and destabilizing expectations or market conditions which could have such an impact on the credit process. Another group centers its criticism on the high level and rate of change in interest rates asking that funds be supplied regardless of the rate of money supply growth. All of this places the President of the United States in a difficult position of coming forward with a strong anti-inflationary program which both U.S. and foreign decision-makers will support as potentially successful. There is little doubt that the President's job would have been easier had he and Congress vigorously supported an anti-inflationary program at an earlier date and had they taken actions to limit increases in minimum wages and the costly price support programs. One even gets the impression that if the dollar were to stabilize in a current range against the currencies of other major industrial countries, the pressure would be off the President to really place before the nation a strong anti-inflationary program. After all, it was only when the dollar began to slide strongly and persistently that the Administration and the Congress became seriously concerned with the anti-inflation effort. They were told that the increasing rate of inflation in the United States would be viewed by market traders as a source of weakness in the United States and that with the very heavy trade deficit the dollar would likely come under intense pressure in the money markets of the world.

One continues to hear today the plea for gradualism for a slow return to less inflationary times. Personally I have some reservations about this prescription because I believe we are dealing heavily in a question of inflationary expectations. A gradual move toward anti-inflationary actions or moves which will only gradually take effect will still leave the expectation of inflation almost untouched in the short run and, after all, the long term is made up of a whole series of short term actions. Moreover, unless actions are visibly credible, the international value of the dollar will continue to erode and this too will place greater inflationary pressures on the United States.

Lest we become too gloomy of either our future or of the policies of our Government, let us remember that in almost all instances of such inflationary growth in the United States, the actual trend of affairs has peaked about the time when people become most seriously concerned. This is not to say that we face the end of an inflationary boom or that inflationary pressures will subside next week, next month or even early next year but merely that the actions already taken by the monetary authorities toward restraining credit availability and raising the cost of that credit have a lag effect and will be biting still further in the months ahead. Also lest you think that I live in an ivory tower with no connection to the real world, let me tie these remarks to a concern of many about the levels of unemployment and the eroding income levels of many American workers. I am seriously concerned about the degree to which people's incomes are eroded by inflation and I am concerned that all who wish to work should have an opportunity to obtain a meaningful position. But I do not believe that actions permitting higher rates of inflation will accomplish either of these goals. Instead it is my belief that only by restricting inflation, only by eliminating this insidious disease, can we bring the true American productive capacity into full force providing new jobs for workers through higher rates of capital spending, and providing the job opportunities necessary for continued growth in real incomes at least commensurate with the nation's productivity rate.

The ultimate question is what can we do about our current situation. We have learned, through sad experience, that mandatory wage price controls are an ineffective, distorting device which merely builds the pressure for higher rates of inflation later on and in fact, takes real wage income from most workers. But if mandatory wage price controls are ineffective, what about voluntary wage price guidelines? With good will on the part of both management and labor, a marginal contribution might develop from such a policy.

But the basic problems are not likely to be addressed by guidelines or controls. Instead the actions of the Federal Government through monetary and fiscal policies still seem to provide the best answers for reducing inflation. One of our basic problems has been that the United States' economy is led by the consumer. Our consumers have learned to buy and to buy heavily saving only a small portion of their total income. Part of this habit is caused by the fact that we pay the saver a negative rate of interest. With the current inflation rate, someone placing funds in a savings and loan or bank which is paying 5 or 5-1/2 percent rates of interest is immediately losing 2 to 3 percent of the value of his money every year and is also taxed on the nominal interest earned.

Another result of the propensity to consume has been the continued demand for foreign goods in this broad market in the United States. Since our economy moved ahead so strongly in the early period following the recession and since our consumers were buying so heavily, our market became the primary target of many foreign nations where the slow growth in their domestic markets was insufficient to absorb the production in their own industries. As a result, the United States developed a very large deficit in its balance of trade, moving from a surplus in the early 1970's to a deficit of more than $30 billion in 1977 and apparently a continuation of about that level in 1978. Of course, the United States could adopt a policy of trade restriction and place large tariff barriers on foreign goods. But our Government believes that a free trade society is best for our nation and the other nations of the world, permitting each nation to concentrate its production in the goods and products which it produces best.

There are those who believe that other nations are deliberately subsidizing their exports and limiting their imports by a series of tariff or tax measures and that the United States should offset such actions by countervailing duties or similar tariff or tax actions. But this is a beggar-thy-neighbor policy which could create ill will, retaliation, and possibly world-wide recession. Instead we must seek the solution within the bounds of reasonable negotiations which permit our products to enter into the markets of the rest of the world while keeping our market free and open.

But if such policies are not attainable by the United States, then where shall we look for relief from this very high balance of trade deficit? It seems to me that part of that relief must come from a somewhat slower rate of growth of the United States economy and a faster rate of growth for the economies abroad. Such a disparity of economic trends could bring greater export demand for our producers and a somewhat slower U.S. market for foreign imports. This would have salutary effects upon the value of the dollar and would reduce the rate of inflation from higher cost imports into the United States. It would reduce the volume of dollars going abroad and thus cut the growth of the overhang of dollars in the hands of foreign official institutions. And it would reduce the problem of monetary conversion of other nations' currencies.

But let us be concrete. What should the United States do to reduce its inflationary problem? I recommend that we embark upon a six-point program.

First, let us temporarily slow the rate of growth in the United States down to 2-1/2 percent a year, a level which will just barely sustain our current level of employment over the next year.

Second, let us remove the impediments to greater savings and investment by paying the savers a positive rate of interest, enlarging investment tax write-offs, and increasing capital gains tax credits. Individuals make the decisions to save or spend and business leaders decide to build new plants and such spending is vitally needed to create job opportunities in the United States.

Third, let us re-examine what we ask our Federal Government to do for us, eliminating those jobs which can be done for ourselves and reducing the spending load required of our Federal Government.

Fourth, let us have the courage and official support to continue our policies of monetary and fiscal restraint so that excessive credit supplies do not provide the fuel to support higher prices.

Fifth, let us bring all elements of management, labor, consumers, and government into a concentrated program of coordinated action so that the debilitating effects of excessive government restraint can be avoided.

And sixth, let us use the revenue margin from government spending cuts to provide tax reductions to keep up real personal incomes and take off the pressure for high wage settlements.

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