REC'D IN RECORDS SECTION
DEC 14 1978

Remarks by

STEPHEN S. GARDNER

Vice Chairman
Board of Governors
of the Federal Reserve System

at the

Securities Industry Association Annual Convention

Thursday, December 2, 1976

Boca Raton, Florida

Gentlemen, it is a great pleasure to be in Boca Raton with you. I wish I could stay here in the sun and balmy air for a little while. I used to every year with the Reserve City Bankers, but my new employers have different schedules. Besides, it is too interesting back in Washington just now, and it's probably not a good idea to stay away too long.

I'm not going to talk about political change today. It's inappropriate for me to do so. Besides, it's not the manifestation of any particular change but the underlying sociological and technological changes that are occurring in this independent world economy that interest me. Further, I am not speaking for the Board, of course, but only from my own experiences during 25 years in the financial business and 2-1/2 years in Government service.

I hope this will be useful. Your program indicates close attention will be given to many aspects of your business with expert speakers, discussion leaders, and panel members from the Securities Industry. But other than your regulator, Rod Hills, only Al Sommers, whom I was sorry to miss yesterday, and Senator Pete Williams tomorrow, and I are the outsiders. This is an opportunity then to focus attention on some basic trends in our economy and even our society that are germane to the business and the future of the securities industry and the economy.

In the present lagging recovery, we have all been concerned about the growth in business fixed investment. Statistically, it is behind the average and relative increases in such numbers during other recoveries in the post-World War II period. I doubt if anyone is really surprised at this. While economists tend to lean on the homogeneity of economic knowledge, each recovery, each recession, is not expected to be a mirror image of some prior similar economic period. A mutation might be a more appropriate term in view of the accelerated pace of change in this world. The uncertainties that still surround the supply and cost of energy and environmental constraints--conditions that were unique to the recent recession--are reasons enough for the lack of investment confidence by business. Add to those problems the possibility that we are a maturing economy in a maturing society, with proportionately larger investment risks (certainly no smaller risks than heretofore) and an absolute decline in the real return on capital and we have enough explanations.

But we have had a recovery, assisted by good crops, continuing strength in private final demand and some moderation in inflation. The difficult liquidity crises have passed for many nonfinancial corporations. The supply of money and credit seems ample and declining rates confirm this. But there is concern in some circles about the prospects for sustaining this recovery. Unemployment is too high. GNP growth is not high enough, and the debates now are raised around the kind or extent of stimulus that will be appropriate and least inflationary as we enter 1977.

I have mentioned two great uncertainties, the supply and cost of energy and the cost of protecting the environment, that have not and cannot be easily dealt with. There are others, of course, which are within our abilities to manage although they will be very painful to deal with. The Government's heavy deficit position and the principal expansion in Federal spending are, as you know, largely the result of the extraordinary growth in social program costs and transfer payments to individuals. Compounding this is the change in the demographics of our domestic society. It is very hard to expect the Federal Government to become a saver and supplier of capital even if we approach full employment. Nor are the costs of State and local governments likely to diminish. The growth of such programs and their cost to the public is startling and suggests that the possibility of crowding out must still be of concern. We are spenders, not savers, publicly. But if we turn to private sector savings, we are repeatedly told that the U.S. has a very low rate of household savings relative to disposable income compared to other leading western industrial nations and also a low rate of all savings as a per cent of gross domestic product if you include corporate, Government, and household savings. It is not surprising, then, that productivity and business investment have lagged seriously in the U.S. in relative terms versus Germany, Japan and other important Western economies. In short, the productivity of labor, the sine qua non of an industrialized society that expects to achieve its social and economic goals, must be our main concern.

I am not a sociologist but in addition to the litany of problems I have cited--constraining capital investment and threatening productivity advances--I am also uneasy about what may be the diminution of incentive in our society. A very large number of Americans have clearly reached the threshold level of want satisfaction. An impressive number live with a surfeit of material goods. If the spark of individual enterprise is sufficiently dampened, we will be fearing for the will as well as the way to continued increases in productivity and the means to achieve whatever social goals you envision.

When I consider the mood in America today from Washington and among the Congress, I sense that the incentives to business investment may be close to the maximum permitted by the political process. The investment tax credit is wearing thin as an off-again, on-again incentive to business. The DISC program has been edited and depletion eliminated for major oil producers. The minimum income tax, probably appropriately, is creeping up. But much of the rhetoric about tax reform does not inspire any confidence that a consensus will be reached that will increase savings and investment.

All of what I have said so far are negative or nagging concerns about the immediate problems we face in our domestic economy. But there is much, much more to consider on a global basis. Sweeping changes have occurred in the economic and political structure of this planet in the last three decades. Putting aside idealogical differences and politics, the struggle to achieve not only relief from hunger, or worse, starvation, and rudimentary economic progress has a new meaning in a world of 160 nations. The formation of numerous independent countries from the old colonial territories has divided and altered dramatically the distribution of the world's basic human and mineral resources and agricultural capabilities essential to achieving human progress. The economies of all nations are growing more, not less, interdependent. Not only for the obvious reasons of raw materials trade and mutual protection treaties but also for more subtle reasons of preserving access to technology, capital and stable financial structures. If we assess our future in this context, it seems to me the basic strengths of the U.S. are not wholly to be measured by our physical resources or military strength or existing productive capacities. I suggest our central role in the world has long been based on some other unique American assets as well.

Let's begin with our economy itself. GNP of one and three quarters billion population of 215 million and a per capita income of $5,526. It's true that our economy is the world's largest, that we have mastered the most complex technologies, that our management skills are highly prized and copied. It's also true that this has created the largest free market for products anywhere. (housing, transportation, clothing, food, etc.) The strength of our partners in the western world is enhanced by their ability to export to our marketplace. Our economy is far more self-contained. Dependency in an interdependent world is heavily weighted in our favor. Further, in the most basic of man's endeavors--agriculture--we have achieved an incredible level of technological efficiency. Our major exports, food, are just as critical to this planet as OPEC's. I do not expect the role of the U.S. in the world's economy to diminish for some time--quite the contrary. Our markets beguile not only our trading partners but those whose social systems are idealogically contrary to our own.

Within this giant economy I see strengths everywhere but I will single out only one example, our private financial structure, although what I suggest may be equally applicable to industry or agriculture. If the U.S. market is key, the dollar is equally essential as the world's obvious trading currency. And the infrastructure of world finance is led by U.S. institutions. American banking consortiums may even be lending as much abroad today as the International Development Banks. They are financing not only commerce and industry but also aspiring nations. Without stopping to critique their actions I just want to point out that our competitive and diverse banking structure bulks as large and is as important to the world as our economy. Similarly, our capital markets are the world's biggest and most important. You may be faced with a variety of problems today and I won't forecast what will be troubling you tomorrow, but the fact remains that without your industry and the U.S. capital market, the ability to marshal investment resources for a great deal of the needed development in the world would be very seriously diminished.

We sometimes don't appreciate an obvious and equally important strength in America. That is the social conscience of 200 million people. The same conscience that fed Europe after World War I, that engaged in the incredible project of world reconstruction after World War II with a volume of aid and grants unparalleled in history. This is simply a fact of American character. It is probably the genesis today of the Civil Rights Movement, the clamor for consumer protection, and environmental restrictions, and openness in Government, and similar current issues. The point is that from the founding of this nation, Americans have had a different view than other peoples about the rights of individuals. I think America has been and will continue to be in the leading edge of social change. And as we apply these ideas, often imperfectly, to a large, industrialized economy, have you noticed how many are watching with interest from abroad? We may be a long time reaching a consensus on the appropriate balance between environmental imperatives and industry initiatives, for example. But wherever we are in the debate today, we are more ahead of our peers than not.

Another great asset has been with us from the start, and that is simply the stable, continuing political process in this republic--now the oldest, unchanged form of such government. I promised not to talk about politics, so I'll just leave that statement on the record.

You may properly assume, then, that I am optimistic and do not see the U.S. reduced to a diminished position in the world order or a less productive and viable society here at home. I think we can reverse the trend of declining gains in productivity, but I have to add a lot of addenda to that brief assumption. I would include the usual admonitions--inflation must be controlled, we must return to wage and price stability. Investment must be encouraged and the return to capital improved. We must rationalize the cost of our social programs at local, State and Federal levels with our fiscal abilities and with the changing demographics of our society. We must vigorously attack the unemployment problems of the disadvantaged, particularly in the urban centers which have to be restored. Those are all standard prescriptions to cure our immediate problems but I doubt that there is a celestial pharmacist who could mix such a medicine.

If we really expect to find that prescription, we must start by restoring confidence--that is not strong enough--respectability and even pride in the private economic system that has built those great strengths that I discussed earlier. However overpowering this task might seem, I think that it is not unmanageable. We have faced it before many times--it has been the story of the evolution of American society. The labor strife early in this century, the depression, and the conditions that inspired the original antitrust laws are the briefest of examples. There have been frequent times in history when citizens lacked confidence in our business system, maybe more times than the converse.

The next speaker on your program--the Chairman of your Committee on Economic Education--may have the most important message to this convention. The timing may even be opportune. Certainly, some of the social turmoil of the late 60's and early 70's has been lessened by the passage of time and thoughtful analysis and discussions. But whether this is so or not, if we are ever to restore wide public confidence in the United States economic system, we need vigorous, articulate and persuasive spokesmen.

To be specific, I have seen a number of efforts to persuade individual Americans that they have a far larger stake in investment than they realize through ownership of not only mutual funds but pension rights and insurance. I haven't been impressed, however, with any attempts to link these arguments to the more basic need for productivity gains. There is too little publicity about the comparisons of our growth and productivity with those of other nations. The investor is key to a process that is at least as important to his future as his own return on capital. Can any parallels be drawn with the unfortunate events in other countries where economic policies have constrained investment and reduced productivity? The private sector including the media can be more objective than public officials in using these economic lessons to our citizens' advantage.

The heavy burden regulation imposes on the economy should be addressed. This is getting to be a better understood problem by the public generally. But, nevertheless, it is also too often accepted by the public as the only answer to perceived unfair practices. The publicity attending boycotts, bribes, corporate political contributions, understandably encourages more regulation. Restoring confidence in business requires more morality in business and self-policing, which, in my view, is a better system than begging for inflexible regulatory controls. We are a society that seeks a whipping boy. Oil companies and multinational corporations fall easily into this category. At least in the latter case, more reasoned explanations of the usefulness of our major firms expanding internationally are needed. Walter Wriston made a key point in his recent essay on "People, Politics and Productivity: The World Corporation in the 1980's." The point to which I refer is his statement that multinationals "are essentially helpless in the hands of a nation state no matter how small." I don't think the public believes that at all, but all I ask for is a fair debate. Other examples of topics are infinite. Consider the discussion about tax loopholes. Somehow the mortgage interest deduction in a country devoted to the principle of home ownership has become a loophole and classed, I assume, with feedlot investments or oil leases.

Nobody has mentioned it too specifically but tax free interest on municipal bonds, I guess, is also a loophole by popular defintion. I wonder how popular that definition would be if all of our townships, boroughs, counties and cities were trying to finance schools, water, sewage, and fire protection without such aid.

It has occurred to me that you may not need all the admonitions or generalities that I have presented today in this brief talk. Certainly, there is no more lively industry closely attuned to trends in society than your business. In fact, you have custody of the world's most significant daily public opinion poll, the stock market. But I didn't hesitate because of the great changes that we have all observed in the investment markets and in your industry. Why have 5 million or so small investors withdrawn their active participation? What has happened to the idea in America that an equity position was important in building financial security in a growing national and world economy? If you had been able to sustain and expand the confidence that the American private investor entrusted to you and American corporations in the post-war decades, you would need no encouragement or criticism from me.

I personally believe that happy condition would have been largely impossible for any number of reasons including inflation, recession, OPEC, the real estate debacle, and the growing regulatory presence of Government.

My purpose today has been simply to encourage you through practice and publicity to contribute to the public's understanding of the economic issues that confront us to ensure a balanced debate on the future course of business and government in our society.

Thank you.