For Release on Delivery
Thursday, SEPTEMBER 4, 1980
7:30 P.M. E.D.T.

Remarks by

Lyle E. Gramley

Member, Board of Governors of the Federal Reserve System

at the
Dinner following the
Dedication of the New Miami Branch Building

September 4, 1980
Miami, Florida

I am very pleased and honored to be with you tonight on the occasion of the dedication of the new Miami Branch building.

As I am sure all of you know, the Miami office began its operations in 1971 as a regional check processing facility--a part of the Federal Reserve System's nationwide program to improve overnight collection of checks. Between 1971 and 1975, economic growth in Miami created the need for a full-service Federal Reserve Branch, and in 1975 the facility was given branch status and began to offer the entire spectrum of Federal Reserve services.

Today's dedication marks another milestone in the history of Miami. The new building is certainly a fine addition to our facilities. Its 245,000 square feet provide very effective space utilization not only for current operations, but also for future expansion at minimal cost, should that be necessary. We can be confident that the new building will facilitate continued efficient operations in Miami.

The addition of the new building comes at a unique time in Federal Reserve history. For many years, the Federal Reserve System has been providing nearly all of the services needed to operate the payments mechanism. Since these services have been provided without charge, the U.S. taxpayer ultimately has paid the bill for financing the operations of the payments mechanism.

The Monetary Control Act of 1980 requires us to make two critical changes in our role as a provider of payments services. First, our doors must be open, not just to member banks, but to all financial institutions that offer transactions accounts. Second, the law requires that prices be charged for services rendered, and that those prices should cover the full costs of producing those services.

Pricing of Federal Reserve services will shift the costs of providing payments services from taxpayers to users of payments services. That will encourage a more efficient operation of the payments mechanism, for two reasons. First, on the demand side, goods and services that are free--or more generally, priced below cost--tend to be utilized in ways that are wasteful. We all now recognize that cheap gasoline promotes too much driving; it is equally true that cheap payments services encourage wasteful use of valuable resources. Pricing will eliminate such waste. Second, on the supply side, by requiring the Federal Reserve to price its services, the new law opens up opportunities for the private sector to compete with the Fed. Competition will help to ensure that payments services are produced at the lowest possible cost consistent with an adequate nationwide level of services.

Just last week, the Board of Governors published for comment its proposed schedule of prices, and its proposals for handling Federal Reserve float. Pricing will be phased in over the course of 1981, so that by October of next year, pricing of Federal Reserve services will be virtually fully implemented.

There has been, and there remains, considerable uncertainty and speculation with regard to the impact of pricing on the banking industry and on the Federal Reserve System. Some banks worry that we may try to price in ways that help us "protect our turf." We cannot let that happen. Our principal concern must be with the efficient operation of the payments mechanism. If private financial institutions can produce and sell payments services more cheaply than the Federal Reserve, the nation will be well served if they do so.

There is, however, as you know, some concern within the Federal Reserve System about how the System can discharge effectively its responsibilities as a central bank if it does not maintain an operational presence in the payments mechanism.

Historically, that is the way the Federal Reserve has carried out its mandate to provide safe and reliable payments services to every section of the country. If the services now provided by the Federal Reserve were produced in whole or in large part by private financial institutions, our nation might be confronted with quasi-monopoly pricing in some markets, inadequate services in others, or the development over time of unsafe payments practices. We must remain alert to see that such a result does not occur.

No one can foresee the outcome of competition in supplying payments services between the Federal Reserve and the private sector.

We have good reason to know, however, that the Federal Reserve will not be easy pickings. We are not a fat, bloated, bureaucracy whose operating costs greatly exceed those in the private sector. On the contrary, during the last six or seven years the Federal Reserve has had a very enviable record of productivity improvement. For example, since 1977, when our present cost and accounting system was introduced, the aggregate annual volume of commercial checks collected by the Federal Reserve System has risen by 14 percent. The total number of personnel working in the check collection function, however, has declined by 4 percent over this same period. Of course, declining numbers of persons producing an expanding volume of services need not reflect increased efficiency; it might simply reflect the adoption of more capital-intensive methods of production. In fact, however, the Fed has become much more efficient. In the second quarter of 1980, the current cost of collecting commercial checks was only 3 percent higher than it was in 1977, despite much larger increases since then in prices we pay for labor, capital, and other inputs. And in some areas of our operations, the improvements in efficiency have been substantially larger than in check collection. For instance, in currency handling, unit costs have declined by over 20 percent since 1977.

Productivity in the Atlanta Federal Reserve District, I am happy to add, has improved at about the same rate since 1977 as the average for all of the regional Reserve Banks. Moreover, the Miami Branch of the Atlanta District is one of the most efficient of any of the 25 branch offices in the Federal Reserve System--based on aggregate measures of quality, cost, and productivity in the operating areas where we have reasonably good statistics.

With the new building that was dedicated today, the Miami Branch will be able to maintain, and perhaps even improve, its outstanding record. It will help the Federal Reserve System enormously in meeting the new responsibilities that we are facing with regard to the payments mechanism.

Let me turn now to the other major challenge that the Federal Reserve is trying to deal with--namely, the problem of inflation. Bringing inflation down must remain our principal concern, even though the economy is still in a recession.

During the past several years, a number of steps have been taken by the Federal government and the Federal Reserve to intensify the attack on inflation. Federal budgetary policy has become progressively more stringent. Energy policies have been put in place that are reducing our dependence on foreign sources of oil and thus our exposure to inflationary increases in OPEC oil prices. Voluntary guidelines have been adopted to restrain wage and price increases in the private sector. The methods of implementing Federal Reserve policy have been changed with an eye to improving the control over growth of money and credit. And in March of this year, the Administration authorized the Federal Reserve to use the powers contained in the Credit Control Act of 1969 to limit the expansion of credit in the interest of controlling inflation. I see some hopeful signs that these steps are finally beginning to bear fruit.

First, the speculative fever that prevailed in commodity markets late last year and in early 1980 has been largely dissipated. It is true that prices of sensitive industrial materials have begun to rise again in recent weeks, as signs of an end to the recession have emerged, but those prices remain well below earlier peaks.

Second, the rise in energy prices has, for the time being, halted. This development reflects more a momentary glut in the domestic and world oil markets. Trends in energy consumption, both in our country and abroad, have been profoundly changed by the increase in real energy prices over the past seven years. In recent weeks, consumption of petroleum products in the U.S. (as nearly as it can be measured) is 6 to 7 percent below a year earlier, and 10 percent below 2 years earlier. Primary domestic stocks of petroleum products, meanwhile, are 12 to 13 percent higher than they were during the summers of 1978 and 1979.

Third, the rate of increase in industrial and service prices excluding energy has slowed markedly, as businesses have begun to price more competitively because of weak demands for their products. For example, in the past 4 months, the rise in consumer prices excluding food, energy, and home purchase and financing costs has been at an annual rate of around 8 percent, compared with a 12 percent figure during the preceeding 4 months.

One area in which no progress at all has been made is in reducing the rise in unit costs of production. In fact, average wage rates during the first two quarters of 1980 increased 2 percentage points faster than they did in the same period of 1979, and productivity growth as yet has shown no sign of improvement. This worsening in the upward trend of production costs was widely expected at the beginning of the year, and should not, therefore, be regarded as a major setback in the fight against inflation. But the very high rate of increase in unit costs of production is the single most worrisome element in the outlook for inflation over the next few years.

In my judgment, however, the most persuasive evidence that our country is making progress against inflation lies not in the statistics on prices and costs, but in the course of macroeconomic policy this year. For the first time in postwar history, a recession has occurred without provoking a massive shift of aggregate demand policy toward stimulus. Monetary policy has continued to foster moderate growth in supplies of money and credit. Discretionary budgetary policy has not shifted toward stimulus in an effort to bring a quicker end to the recession.

Such budgetary policy pursued during a steep recession is truly remarkable. It reflects a growing recognition by Americans in every walk of life that inflation is the most serious economic problem we face, that there are no easy solutions to the problem, and that ending inflation will entail a significant tightening of the belt. Fighting inflation, even in a recession, is therefore good politics. It is also good economics. Economic policymakers now recognize that efforts to use fiscal policies to cushion recessionary tendencies have, in the past, been largely ineffective, as the Joint Economic Committee indicated in its recent mid-year Report. The stimulus usually has come too late to shorten or soften the recession and sometimes has occurred when it was not wanted.

The economic reasoning underlying the current course of monetary and fiscal policy is that automatic stabilizers in the budget and in financial markets will be sufficient to bring an end to the recession. That logic appears to be working. In sectors in which spending is particularly sensitive to developments in credit markets--such as housing and autos--activity has begun to pick up again. Signs that an end to the recession is near at hand are multiplying. In July, retail sales rose significantly; employment increased; initial claims for unemployment insurance declined; new orders for durable goods rose sharply; industrial production fell less than in the prior 3 months, and the index of leading economic indicators increased for the second consecutive month. A recovery in general business activity may well emerge during the next month or two. If so, the recession of 1980 will turn out to be one of the shortest in postwar history, despite the absence of governmental actions to cushion the decline.

The course of policy our country has adopted this year is, indeed, heartening, but we are still a long ways from our objective of stable prices.

If we do not persist in keeping the fight against inflation at the top of our priority list, the gains we have achieved to date--at heavy cost in terms of lost jobs and output--could easily be frittered away. For example, in recent weeks interest rates have moved up in response to increasing demands for money and credit. Cries of alarm have already begun to be heard. I share the view that interest rates should not rise enough to choke off recovery. But some rise in interest rates as the recovery proceeds is an inevitable part of a monetary policy strategy that puts primary emphasis on bringing inflation down over the long run.

I believe we need a tax cut next year to offset the effect on tax burdens of the windfull profits tax, the scheduled increase in payroll taxes and the rise in marginal tax rates because of inflation. It should be of moderate dimensions, and targeted carefully to achieve anti-inflation benefits. If it has those characteristics it will make a positive contribution both to encouraging recovery and reducing inflation.

We should be wary of claims that wholesale tax reductions will produce miracles on the supply side, and are therefore non-inflationary. Careful, well-documented, work on the effects of supply-side cuts on output and productivity is largely confined to studies of the effects of business tax cuts on capital formation and productivity. Beyond that, supply-side economics is based about as much on conjecture as on empirical analysis. At this critical stage of the fight against inflation, we can ill afford to make large reductions in tax rates on the basis of untested hypotheses.

The agenda of things that need to be done to regain price stability begins with the pursuit of prudent, carefully-designed, fiscal and monetary policies. It does not end there. It is crucial that we make the fight against inflation a part of every governmental policy decision--whether it be energy policy, environmental and social regulations, import restrictions, loans to troubled industries, agricultural policies, or others. Consistent, anti-inflationary, policies in all of these areas are essential to regaining price stability.

Next year, our economy will be recovering from the recession of 1980. In every previous postwar recovery, the inflation rate has always risen. This time, history must be stood on its head; we must begin to bring the inflation rate down even as the economy moves back toward higher levels of resource utilization. That is an ambitious goal, but it is clearly within our reach. It is the objective to which we at the Federal Reserve are strongly committed.