For release on delivery
2:00 p.m. E.D.T.
June 1, 1983

Statement by

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before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Finance, and Urban Affairs

U.S. House of Representatives

June 1, 1983

I am pleased to have this opportunity to discuss the current employment situation, which, quite rightly, is a matter of great concern both to the members of this committee and to the Federal Reserve. As you are well aware, the nation's unemployment rate reached a postwar high during the recent recession; and although labor demand is now strengthening, one-tenth of our labor force was still unemployed when the most recent labor market surveys were conducted in mid-April. Similar problems of high unemployment characterize our trading partner nations because of a long period of slow growth in the world economy.

This recent period of high unemployment has disrupted the lives of millions of willing workers and their families. Many persons who held jobs have lost them in the wake of declining economic activity. Others, seeking jobs for the first time, have been unable to find them, and have instead fallen into the ranks of the unemployed. Still others, discouraged by poor labor market conditions, have dropped out of the labor force altogether.

Obviously, an employment situation like this creates extensive strains within our society. We can point with considerable pride to our success in reducing inflation over the last two years. However, that gain would represent only a partial success if it were to leave a large part of our workforce outside the mainstream of economic life for extended periods. Therefore, we at the Federal Reserve share this committee's interest in exploring the dimensions of the current employment situation and in seeking ways in which it might be constructively addressed. In my remarks today I will focus on the broad dimensions of the economic situation, particularly as it affects labor markets, and will indicate what, in my view, the Federal Reserve can do--and cannot do--to help establish a climate for sustainable improvement in economic activity and employment. My colleague, Mr. Silas Keehn, President of the Federal Reserve Bank of Chicago, will then focus on the particular employment problems of several of the states within his Reserve Bank's district.

At the present time our economy is emerging from a most trying and difficult period. Throughout the 1970s we were afflicted by an increasingly virulent inflation that, by the end of the decade, was threatening to undermine our economy in rather fundamental ways. The underlying inflation rate had accelerated to the double-digit level and seemed likely to go higher. Price speculation was spreading into the decision-making processes of both businesses and consumers, and the dollar had weakened considerably in foreign exchange markets. An even more troubling development was that high inflation was coming to be viewed as a permanent feature of our economy; more and more, inflation was being built into the structure of interest rates, and rising inflationary expectations were exerting an increasingly strong hold on the behavior of savers and investors alike.

This gradual worsening of inflation, and the application of restrictive policies necessary to bring inflation under control, eventually culminated in a prolonged period of economic stagnation. On balance, from mid-1979 to late 1982, there was little change in real output, and our economy fell substantially beneath its potential to produce. In labor markets the total number of unemployed workers rose by 5-1/2 million from late 1979 to the end of 1982, and the unemployment rate reached a maximum of 10.8 percent, about 5 percentage points above the lowest point reached during the economic expansion of the late 1970s.

The long period of economic stagnation and rising unemployment affected most industries, regions, occupations, and demographic groups. The most serious impact, however, was felt by the cyclically sensitive construction and durable goods manufacturing industries, many of which already were facing difficult transitions because of heightened competition from foreign producers. In some key sectors--including steel, autos, and lumber--operating rates fell to extremely low levels, and economic hardships became widespread in the communities that were dependent on these industries. Unemployment rose especially rapidly among adult men, who hold a disproportionate number of jobs in the durable goods producing industries. Among blacks and teenagers, unemployment rose further from rates that already were far above the national average. As the period of economic recession became more prolonged, the number of long-term unemployed rose to an exceptionally high level.

At the same time, despite a discouraging labor market situation overall, there continued to be signs of underlying employment stability in several sectors--and even a few pockets of vitality--as the rapid growth of new industries led to expanding job opportunities. For example, the service sector of the economy continued to grow throughout the recession and now employs 1-1/2 million more people than it did at the beginning of 1980. Over that period, the use of computers in our economy increased especially rapidly, and the number of workers providing computer and data processing services, though still a small share of total employment, has risen by more than a fourth in the past three years.

Because inflation had become so deeply embedded in our economy, prices kept rising rapidly in 1980 and 1981, even as the economy was falling into recession. Inflation in 1980 remained near the double-digit level, and in 1981 the slowing of prices was mainly confined to a few sectors of the economy.

In 1982, however, the application of policies to combat inflation began to bear substantial fruit. The slowing of price advances became more widespread and potentially more lasting, as all major price indexes advanced at considerably slower rates than in 1981. For some price measures the increases in 1982 were the smallest in more than a decade, and price developments have continued to be quite favorable into early 1983.

It is true that part of that slowdown in inflation reflected the influence of special developments in agricultural and energy markets. However, there have also been strong indications of more fundamental gains, as the wage-price interactions that had helped perpetuate inflation through the 1970s began losing their momentum. Many businesses have been adapting their pricing policies to the realities of a more competitive and less inflationary economy. Work rules are changing as firms strive to bolster productivity and trim costs. At the same time, workers are agreeing to smaller pay increases than in earlier years; but, happily, with inflation falling so rapidly, the slowing of nominal wage increases generally has been consistent with gains in real purchasing power. A slower rate of increase in labor costs is relieving pressures on prices, and in turn a slowing of prices is damping inflationary expectations and relieving workers' fears of falling behind in an inflationary spiral.

For the time being, at least, this cumulative process of disinflation appears to be continuing. Wage adjustments so far this year have been holding at a reduced pace similar to that of late 1982, and recent price developments have been exceptionally encouraging. The consumer price index rose at about a 2 percent annual rate over the first four months of this year, and the producer price index actually fell at nearly a 4 percent annual rate during that same period. Although these price data were influenced in part by declining oil prices early in the year, they also are indicating a continued easing in underlying inflationary trends.

Curbing the momentum of inflation is now beginning to have the salutary effects on real activity that had long been anticipated. The halving of inflation rates during 1982, as well as a number of other factors, contributed to substantial declines in interest rates over the second half of last year. As a result, activity began to improve last summer in housing; gains in consumer spending started to appear last fall; and in recent months a broad number of other economic indicators have been pointing to a strengthening economy. Barometers of consumer attitudes and business sentiment are strongly improved, and increases in production and sales are now apparent in a wide range of industries.

The upturn in economic activity has, in turn, led to some firming of labor market conditions. The rate of layoffs began slackening in late 1982, and the unemployment rate has started to come down from its peak level. Total payroll employment has increased by about 650,000 since the end of last year, with more than one-third of those gains coming in the manufacturing sector, in which employment had previously declined steadily for a year and a half. So far, the gains have been about average for the early stages of a recovery.

The price and employment developments since the beginning of the year have been broadly in line with the economic expectations held by members of the Federal Open Market Committee and included in our February monetary policy report to the Congress. The general thrust of those projections, you may recall, was that activity and employment were expected to expand at a moderate rate this year and that the pace of the recovery would be consistent with further progress toward price stability. With the recovery apparently gaining momentum in recent months, I believe that there is an excellent chance that this year's economic performance will be at least as good as was projected in mid-February.

At the same time, a number of potential obstacles to sustained economic growth were apparent when the monetary policy report was prepared, and despite the favorable economic developments of the past few months, those obstacles still confront us today. Foremost among these is the prospect that Federal budget deficits will persist at very substantial levels in the years ahead, even as the economy moves well into an expansion. The federal deficit in the current fiscal year is expected to exceed 6 percent of GNP, and unless constructive action is taken, this share will remain extremely large in the years ahead. In part because of these prospective mega-deficits, intermediate and long-term interest rates remain high relative both to their historical levels and relative to current inflation rates, and financial markets remain unsettled, reflecting concerns that the deficits will keep pressures on interest rates and eventually lead to a renewed surge of price inflation.

Concern about a budget-induced resurgence of inflation is symptomatic of a more widespread and still persistent fear that inflation has been brought under control only temporarily and that it will escalate again once a new expansion has gained momentum. To a considerable extent, that fear arises from more than a decade of failed efforts to reduce inflation for more than brief periods; and because such expectations of inflation are still very much in evidence, we must be especially prudent in designing monetary policy in the period ahead. In particular, focusing monetary policy solely on the need for rapid growth and ignoring the still-present threat of inflation would risk surrendering the gains that we have made against inflation at such a high social cost.

To be sure, the task of controlling inflation and restoring growth should not be viewed as the responsibility of monetary policy alone. Fiscal policy, too, must do its part. I am well aware that Congress and the Administration are sensitive to the dangers of the looming budget deficits; but at the same time the events of recent weeks illustrate the great difficulties of reaching a consensus on how best to reduce these deficits. While mindful of these difficulties, I would strongly urge you to continue seeking positive solutions that mitigate the dangers associated with persistent, huge structural deficits.

Other obstacles to an economic recovery reflect current difficulties in the world economy, into which we have become increasingly integrated in the past decade. Poor economic conditions in foreign nations, as well as a strong dollar, have limited U.S. exports in the past two years and have contributed importantly to the loss of jobs in several of our basic industries. This external drag on our economy, if it were to continue, would be an impediment to renewed expansion in the U.S. economy. Perhaps an even more serious development is that the prolonged period of slow growth worldwide has exacerbated debt-servicing problems in the developing nations and is causing a rise in protectionist sentiment in the industrial nations. The dangers inherent in this world economic situation are substantial; but they are not insurmountable, and I remain hopeful that we can deal with them successfully through the cooperative efforts of private and public institutions.

So long as we make progress toward solving these difficulties, both at home and in the international arena, the most likely outcome for our economy will be that of expanding activity and declining unemployment. Those gains, of course, may not be steady from month to month and will not show up evenly in all sectors. Indeed, because of the stresses and uncertainties spawned by many years of high inflation and slow growth, many businesses will likely be hesitant to expand investment and employment until there are more convincing signs that the recovery will prove lasting. Unemployment, therefore, will probably still be at a high level at the end of this year.

What matters most, though, is not the pace of the recovery in its first few months, but whether we can achieve a broad-based and sustained expansion; and it is to that end that our current policies must be directed. Monetary and fiscal policies must necessarily share responsibility for the long run state of the economy, but at the same time we should be fully aware of the particular ways in which monetary policy can influence the economy and of the ways in which its influence is limited.

Economic analysis shows rather convincingly, I believe, that monetary policy can be a contributing factor determining the rate of growth in nominal income, but that there is no certainty that a particular monetary policy will have the intended effect on real economic activity and employment, particularly in the long run. One of the lessons learned in the past decade is that there is no reliable trade-off between inflation and unemployment, and because the dangers of inflation were neglected far too long the process of moving back toward a more stable price environment has become quite lengthy and very costly.

We would all agree, I think, that what we want ultimately for our citizens is an environment of rising real incomes and expanding job opportunities. I am convinced that the best way the Federal Reserve can help achieve that end is by working to establish the kind of noninflationary economic expansion that can be sustained for a long period. Given an economy in which there is confidence of continued price stability, a steady rise in employment and in living standards is likely to follow.

There remain, Mr. Chairman, the difficult questions of the extent to which the present recovery might reduce unemployment and, conversely, the extent to which "structural," as well as "frictional," unemployment would still persist even when the economy has returned to its long-run noninflationary growth path.

The concept of structural unemployment is obviously a useful one in that it seeks to identify that portion of total unemployment that is less related to the normal workings of the business cycle and for which special programs that seek to attain a better match between workers and jobs might prove effective.

Structural unemployment has long been a problem among certain groups--teenagers, for example--who often lack the training needed in a rapidly changing labor force. But, it also arises as patterns of labor demand shift in association with such factors as changing population patterns, technological advances, and the increased competitiveness in international markets. Typically, these structural changes occur gradually, with diminished employment in some regions and industries being offset by an expansion of job opportunities in other areas. Because it takes time for dislocated workers to obtain new training, to relocate, or to revise their wage expectations, the spells of unemployment for these workers tend to be particularly long.

In practice, unfortunately, there has never been a clear-cut analytical or statistical distinction between structural unemployment and cyclical unemployment, and attempting to apply the distinction is especially difficult in the current period. It may well be, for instance, that structural change has occurred at an unusually rapid pace in recent years, and that some industries will continue to fall well short of their previous peak levels of activity, even with a healthy and sustained economic recovery. Presumably, some of the workers displaced from those industries will discover new employment opportunities in sectors that are expanding, such as the high-technology industries. But such employment shifts take time, and there is legitimate concern about whether the new industries can absorb expeditiously the workers dislocated from declining industries, especially given differences in geographic location and required job skills.

Our historical experience suggests that a portion of today's unemployment problem--probably a sizable portion--can best be alleviated through macroeconomic policies designed to encourage a sustainable recovery in activity, and some of the problems that now appear structural may disappear as activity recovers. Nevertheless, it appears that a significant unemployment problem is likely to persist even in a steadily expanding economy. In the late 1970s, for instance, the unemployment rate dipped only slightly below the 6 percent mark, even after four years of economic expansion, and at present it does not seem likely that the rate will drop back to that level any time soon. Indeed, the difficulties of reducing unemployment in the period ahead may be exacerbated by the deep-seated, and perhaps irreversible, changes that are affecting many of our primary industries.

Unfortunately, monetary and fiscal policies are ill-equipped to deal with the special problems of structural unemployment. However, over time a number of programs have evolved to address the difficulties of the structurally unemployed. The approaches taken have included training and educational programs, relocation assistance, and special job creating policies. We are still learning whether some of these approaches, when carefully crafted to encompass the cooperative actions of business, labor, and government, can contribute to an easing of the unemployment problems that confront us. A particular challenge for the period ahead will be to adapt these approaches so as to best aid those workers displaced by the rapid changes now occurring in our industrial sector.

In conclusion, Mr. Chairman, monetary policy best serves by continuing to be focused on fostering a lasting expansion in business activity within the framework of continued progress against inflation. At the same time we recognize fully our responsibilities in promoting safety and soundness in the financial markets and in supporting a strengthening of the international financial system. This nation has experienced the difficult adjustment process of restructuring for a productive, less inflationary economy after a decade of low productivity and destructive inflationary pressures. The human and economic costs of this disinflation process have been high. We cannot step back now from our commitments and thus jeopardize the gains that we have garnered to date. The health and sustainability of the economic recovery depends, of course, not only on monetary policy, but also on fiscal policy, in particular on whether policymakers can reduce the dangers of massive out-year budget deficits. With a responsible fiscal policy to complement the monetary policies now in place, I am confident that the recovery can prove a durable one, associated with rising living standards and increased employment.