CHOICE AND THE ECONOMIC OUTLOOK FOR 1973

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by

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Recovery in 1972

In this, the final month of 1972, we can look back with some satisfaction about the progress the American economy has made during the year. The year has been one of solid economic achievement. The nation's output of goods and services as measured by the Gross National Product will probably end up over 6 percent greater than in 1971, measured in dollars of constant purchasing power. The rise in real GNP in 1971 was only 2.7 percent. Thus, we have gone a long way toward achieving complete economic recovery.

By achieving this substantial rate of economic growth, the American economy has once again demonstrated its fundamental strength. The economy has demonstrated its remarkable ability to operate under adverse circumstances and to rebound from what could have turned out to be devastating blows.

Both favorable and unfavorable political and economic developments have occurred with such rapidity during 1972 that it is obviously impossible to give a complete catalogue of all the major events for the year that have influenced the economic environment. But here are some of the most important.

Early in January, you remember, numerous persons were offering themselves as presidential candidates, and in the months that followed there was a considerable amount of name-calling, accusations, and counter-accusations.

In February, the President visited China, and it was announced that the U. S. balance of payments deficit for 1971 had been the greatest on record. In the same month, the Irvings admitted the Howard Hughes hoax.

In March, the United States suspended the Paris peace talks, and labor representatives left the Pay Board. In the same month, North Vietnam launched a new offensive.

In April, the dollar was officially devalued.

In May, Governor Wallace was wounded.

In June, Great Britain gave up the struggle to maintain parity and began to float the pound. Hurricane Agnes came along in the same month.

In July, the Democrats met, and Soviet advisers were ordered out of Egypt.

The following month the Republicans held their convention.

September brought the Olympic massacres and subsequent tensions.

October saw the Arab hijackers. That month, Great Britain adopted a wage and price freeze.

In November, the American people chose their President and other officeholders.

And so it went throughout the year.

Some of these events were tragic; some were constructive; and not all of them had as much impact on the American economy as the newspapers might have led us to suppose. Yet, while these and other headline-grabbing events were taking place, the American economy kept right on functioning. While some Americans were protesting and demonstrating and while some were engaged in labor disputes, over 80 million Americans kept right on working at their jobs. As a matter of fact, the number of working Americans increased during 1972 by over 2 million. More than enough new jobs were created to take care of the growing labor force and thus lower the rate of unemployment.

With more persons at work, there has naturally been a substantial increase in personal income and consumers have been able to satisfy more of their needs and desires by stepping up their spending. Their spending, of course, has helped sustain a higher level of industrial production. Profits have increased, construction is booming, and the economy generally has continued to improve.

All of this has been achieved without a substantial increase in interest rates. Most interest rates reached peaks in July 1971. Despite an expanding economy, long- and short-term rates are still below these peaks.

We have even made some progress in slowing down inflationary price pressures, even though progress has not been as great as we should have liked. One month's slowing down in consumer prices seems to be followed by a disappointingly high rise in the following month. Nevertheless, we can point to some progress over the longer run in the price situation generally. Using what is called the GNP deflator, we find that in early 1970 prices were rising at an annual rate of about 5 percent. In 1971, the rate was about 4.5 percent. By the third quarter of 1972, the rate had been reduced to something like 2.5 percent. Especially gratifying has been a sustained improvement in productivity.

Perhaps the slowing down of inflation is a tribute to the United States' ability to handle its economic affairs, perhaps not. Nevertheless, we note that prices in the U. S. rose less during 1972 than in most other countries. Last August, for example, the percent change over a year ago in consumer prices in the United States was 2.9 percent. For the same period, the increase was 6.6 percent in Great Britain, 5.1 percent in Germany, 6.1 percent in France, and 7.5 percent in Holland.

You and other Alabamans have shared in this economic expansion. This is shown by the 18-percent increase in total bank deposits at our member banks in Alabama over the past year and the increased checking account activity. During the first ten months of 1972, debits to demand deposit accounts were 20 percent greater in Alabama than in the corresponding period of 1971.

Continued Expansion in 1973

We also derive some satisfaction from noting that the consensus is for a continued economic growth during 1973. On an average, business economists expect the growth in GNP in real terms to be about 6 percent in 1973. Some slowdown in the rate of growth is expected because the economy will be operating at very near capacity. According to these prophets, employment will get down to 5 percent in the final quarter of 1973. And we can achieve this growth with a slight slowdown in the rate of general price increase to one of between 1 1/2 and 3 percent.

There seems to be statistical evidence to support this optimistic outlook. Planned plant and equipment spending is high, consumer confidence is increasing, and diminishing inflation can be expected to bolster confidence further.

I believe that Federal Reserve policy has also contributed to the economic recovery, although Federal Reserve policy is only one element that contributes to economic growth.

In early 1972, the high rate of unemployment and other evidence of slack in the economy suggested that a moderately stimulative Federal

Reserve policy would be appropriate. Consequently, Federal Reserve policy, through its open market operations, has continued to foster a moderate expansion in the monetary aggregates while at the same time it has tried to avoid an excessive rate of expansion that might later result in increased inflationary pressures. Maintaining a steady growth in the monetary aggregates is easier said than done because of technical difficulties. Thus, during 1972 the rates of expansion have been greater in some months than in others. Nevertheless, through the first eleven months of 1972, the money supply--that is, currency and demand deposits--has expanded at a seasonally adjusted annual rate of 7.3 percent.

Earlier, we noted that business economists and others who are experts--or qualify themselves as experts--on economic forecasting forecast continued economic expansion in 1973. Most of these forecasters, I suppose, arrived at their conclusions by examining and weighing a mass of statistics, by using their econometric models, and by using various other scientific methods.

I will not pretend that I am any kind of an expert in the use of econometric models. Neither do I always have complete faith in what these econometric models produce because no mathematical formula can capture completely the human element. Nevertheless, these forecasts seem reasonable. I reach this conclusion after assuming, perhaps with naive optimism, that the human element will make the choices that are essential for continued economic expansion without excessive inflation. We continue to have economic problems, but I have faith that in the long run the good judgment of the American people will be able to solve these problems.

Making the Hard Choices

First, there is the problem of persisting unemployment. Unemployment, according to the latest figure available, is at a rate of about 5.5 percent of the civilian labor force. The rate was 6 percent at the start of 1972. Thus, we have made some progress. Nevertheless, the reduction in the rate seems to be agonizingly slow. Consequently, some are tempted to advocate massive doses of monetary expansion and further deficit spending on the part of the Federal government. "What if it results in accelerating inflation?" they ask. "Is not reducing unemployment one of our primary goals and thus worth paying the cost of inflation?"

It is hard to argue with anyone about the desirability of giving more people jobs. Moreover, joblessness creates social unrest and undermines the stability of our society. But fewer persons seem to accept the idea that greater inflation automatically reduces unemployment. The American people apparently are deciding that the answer to reducing unemployment is not the simple one of producing more inflation.

For one thing, they have begun to pay closer attention to the structural character of unemployment. They note that unemployment tends to be concentrated among the unskilled, the young, and the inexperienced. For example, in contrast to the overall rate of 5.5 percent, the rate for married men is only 2.8 percent, about as small as possible. On the other hand, the teen-age unemployment rate is 15.3 percent, and the rate for all black workers is over 10 percent. I am sure that being unemployed makes a teen-age worker just as unhappy as one of another type. But the concentration of unemployment among certain groups suggests more inflation will not necessarily solve the problem of eliminating these concentrations of unemployment. I cannot prescribe a detailed remedy here, but I am becoming more confident that the American people will have the good judgment to deal with this problem in a more effective way than by inflating the economy.

I am also encouraged by what seems to be an increasing tendency on the part of responsible persons to take a sober and constructive approach in dealing with our continued international financial problems. They seem to be less confident that there is a quick and magic solution. Despite the progress through the Smithsonian Agreement, international financial problems continue to plague not only the United States but most other countries of the world. The U. S. balance of payments continues in substantial deficit. Despite devaluation, U. S. imports continue to exceed exports. The October trade figures do show some improvement, and the prospects are that we shall, as time goes on, begin to reap more of the beneficial effects of devaluation.

I have some confidence that our trade position will improve because the American people seem to have been able to come to grips with inflationary problems better than people in many other countries of the world. More and more Americans seem to conclude that price stability is the only way we can maintain this nation's position in the world's markets. Thus, we may find in the not-too-distant future that we are no longer pricing ourselves out of the market, especially if the United States continues to do a better job than many other countries in combating inflation.

The optimist can also make a good case that we shall be able to solve the major problem of getting our Federal finances under control. More and more persons seem to be facing up to the damage that continued high Federal deficits can do to our economic stability and our efforts to control inflation. Here again, my optimism depends primarily upon my optimistic assessment of the human element.

During a period of recession, a good case can be made that a large Federal deficit is appropriate as a means of stimulating economic recovery. However, when the economy is approaching full employment, a large deficit carries with it dangerous inflationary implications. Consequently, a good many of us are frightened about the possibility of a huge Federal deficit continuing in 1973 and subsequent years. Current estimates of exactly how large the 1973 fiscal year deficit will turn out differ, but some of them suggest that, unless conditions change, we could closely approach $30 billion. Even more alarming is that the proposed deficit spending could continue in fiscal 1974. If so, the Treasury will have to compete strongly for funds with the private sector and add its demand pressures to the strong demands of the private sector on the resources of the economy. The inevitable result will be inflationary pressures. If this happens, we shall have thrown away most of the gains we have made toward reducing inflation along with the prospects of improving our international trade position and postponing further the time when the economy can operate without the harness of controls.

Some of us are inclined to hold some vague entity we term "the administration" responsible for eliminating the deficit. We all call upon the administration to reduce the Federal deficit. It is the American people who must make certain choices because the President and Congress pretty well reflect our attitudes. Far too many of us say to them, "Cut the Federal deficit but don't reduce our favorite expenditures or raise our taxes."

I should suspect that several of us here today have, vocally or in writing, deplored the Federal deficit, perhaps to our Congressmen. But I wonder how many of us have told our Congressmen to cut specific expenditures for our own local projects. How many of us, for example, when we learn that the military base near by is going to close write the Defense Department voicing our approval? How many of us have told our Congressmen that we want higher taxes?

Perhaps I am naive in expecting this to happen. You may say that it is contrary to human nature. If we are sincere, however, in wanting to cut down the inflationary Federal deficits, we are going to have to give up some of the benefits we think we gain from specific expenditures or pay higher taxes. If we do not do this, we shall choose inflation and we are going to get the kind of fiscal policy we deserve.

Looking back, I have observed that at various periods Americans have persisted in making mistakes and following incorrect policies. But eventually they seem to have realized their errors and taken steps to correct them. That seems to be happening right now. More and more persons seem to be facing up realistically to what is involved in eliminating the inflationary impact of continuing high Federal deficits. I am therefore hopeful, if not completely confident, that the number of those persons will increase to the point where the administration and Congress will know unmistakably that they have the support of the American people in getting the Federal budget under control.

The Human Element and Federal Reserve Policy

As I have discussed each one of these problems--the stickiness of unemployment, the international financial difficulties, and the Federal deficit--I have always ended up by relating each problem to inflation. This is no accident. Each one of these problems is tied up with inflation, and solving these problems is intimately related to controlling inflation.

We can paint a gloomy picture that will show inflationary pressures increasing rather than decreasing in 1973. Our unused productive capacity is disappearing. We can expect demands to become stronger if the economy continues to grow. There are numerous wage settlements scheduled for 1973 that, if settled for excessive amounts, could set off an inflationary wage-price spiral. We have the prospect of a large Federal deficit. There seems to be a growing acceptance of the idea that, since inflation is inevitable, we ought not to fight it. Moreover, some businessmen seem to be becoming more and more entranced with controls and becoming more and more reluctant to face up to the fundamental problems whose solution would make controls unnecessary.

All of these developments can take place. But whether they do or not depends again on the human element.

The human element, for example, is going to be tremendously important in determining how much Federal Reserve policy can contribute to reaching our goal of sustainable economic growth and stable prices. Federal Reserve policy reacts to the economic environment, and it is the human element that sets that environment. Americans will decide whether or not they will allow Federal Reserve policy to function and whether or not they will provide the kind of economic environment in which it can function effectively.

I don't think anyone in the Federal Reserve System would challenge the idea that the growth in the money supply and other monetary aggregates should be kept in check. Growth should not be too fast, and it should not be too slow. Growth in the monetary aggregates probably ought to be at higher rates during a period of economic recession than when the economy is operating at nearly full capacity. There are, of course, differences of opinion about how best to accomplish this, but everyone in the System agrees that we ought to work as hard as we can toward contributing to sustainable economic growth and stable prices. Will you let us do the job?

For example, if the economy continues to expand toward complete economic recovery and almost complete utilization of our productive capacity, a lower rate of growth in the money supply would seem to be appropriate. If this happens, we might expect to find interest rates rising. What will be the American public's reaction? Will it be willing to let interest rates perform their function of equating the demand and supply of funds, or will the public demand some kind of ceiling on interest rates? If interest rates begin to attract funds from one type of use to another, will the public demand controls? Will the public demand that some sectors of the economy be insulated against the effects of interest rates? Will demands be made that when the Federal government borrows it ought to enjoy a privileged position?

If the majority of Americans answer, "Yes, we want to keep interest rates from performing their basic function of allocating funds," we shall, of course, find that Federal Reserve policy will be ineffective in helping stabilize prices. I hasten to say that I am not predicting that we will necessarily have higher interest rates. What I am emphasizing is that for monetary policy to be effective we must allow interest rates to reflect basic economic forces. It seems to me that more and more Americans have concluded that, if they must choose between some pressures on interest rates and higher prices, they will elect the former.

We Americans also have another important choice that we may be forced to make. If we are going to rely upon the general controls of monetary and fiscal policy to bring about the necessary adjustments for sustainable economic growth and stable prices, we are going to have to provide a generally competitive environment. This environment is essential to bringing about necessary economic adjustments.

You will recall that, when Chairman Burns of the Federal Reserve's Board of Governors first proposed an incomes policy in 1970, he did not talk solely of wage and price controls. As a matter of fact, they were a relatively minor part of his total program. He included in his recommendations the fostering of a competitive environment by liberalizing import quotas, enforcing the antitrust laws more vigorously, and reducing restrictive building codes, for example. In addition to recommending the development of some kind of machinery to keep wage settlements in line with productivity, he also pointed out the need for restraint in pricing.

Current fiscal and monetary policies can help create a noninflationary economy without controls. We can't expect to have this kind of economy, however--no matter how good our fiscal and monetary policy is--unless we have a competitive economy. I am confident Americans will make the right choice.

You ask me, "What are the economic prospects for 1973?" I think they are good. I think they are good because I believe we Americans are developing, on the basis of experience, the ability to make the correct choices. We shall choose a policy of fiscal responsibility even at the cost of giving up some of the benefits we believe come to us as individuals from greater government spending. We shall choose to allow monetary policy to function, and we shall decide we want a competitive economy.

The choices we shall make will determine the outlook not only for 1973 but for years to come.