

STRATEGIES FOR STIMULATING THE ECONOMY

Remarks
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by

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Discussing the economy with this audience is always a privilege and responsibility. Speaking about the economy at this moment is especially difficult because it is too early to assess the full effect of the cold weather. But we can focus on the longer-run problems and reflect on 1976.

As a whole, 1976 was a fairly good year for the economy. The year began very well indeed. Then the recovery paused during the summer and early autumn. Retail spending leveled off for about six months. Industrial production declined briefly. Federal spending fell short of budgetary expectations. Capital investment expanded less and at a retarded rate.

To spur the economy, the new Administration proposed, and Congress is already debating, a two-year \$31.2-billion plan. But, does the economy need a strong shot in the arm? Will it slip into recession unless fiscal stimulus is applied? I think not for several reasons.

We have avoided many economic excesses of the past. Overborrowing and overlending are not present on any major scale today. Exuberance and speculation have been replaced by conservatism and caution. So the usual signs of a new boom-and-bust cycle are lacking.

Another reason for optimism is that inflation slowed in 1976. Also, the Federal Reserve kept credit readily available. And, partly because of reduced inflation, interest rates are near their lowest point in four years.

In addition, signals from the economy show that the pause, or lull, ended in late 1976. Production rebounded. Retail buying strengthened. Home-building picked up. And, evidently, government spending was back on track. So, according to many indicators, the beat of the economic tempo in the closing months of 1976 was much better than that of a few months earlier.

The economic figures for the opening months of 1977 will probably tell a different story. Frigid weather and natural gas shortages have resulted in production curtailments. Employment and income have weakened. Higher heating bills and price hikes on fresh fruits and vegetables are chilling people's pocketbooks.

When you make allowance for cold weather-related losses, the economy's current pace still seems fairly good, though in real growth it is much lower than the 6-percent rate recommended as a national goal by the business-oriented Committee of Economic Development. President Carter also set 6 percent as a goal for 1977.

What are the prospects for solving the unemployment problem? A quick reduction in the nation's unemployment rate seems unlikely. Typically, unemployment falls sharply in the early stages of a recovery; this time, the reaction was atypical, unemployment did not react as was expected. Insufficient economic thrust and rapid labor force growth share much of the blame. Economic growth was not fast enough

to absorb the influx of 2 1/2 million employment-seeking persons in 1976.

This suggests that unless there are fewer jobseekers, particularly women, the future unemployment rate may not decline even if real economic growth rises to 6 percent or above. With more and more two-job families, higher unemployment seems inevitable, at least for a while.

The cold weather-related losses in the economy should be largely made up once the weather warms up and more gas becomes available. Does this mean the economy is headed for a dramatic upsurge throughout 1977? It's doubtful. True, corporations have stepped up equipment buying; but they have also shown reluctance to move ahead with major construction projects. The Commerce Department has reported, in almost all recent quarters, that corporations actually spent less on plant and equipment than the amounts they projected earlier in these categories. Industry's plans, as reported in the latest surveys, indicate that total business capital spending, adjusted for inflation, will increase only modestly in 1977.

Other constructions areas remain sluggish, especially the commercial and public sectors. Meanwhile, state and local government spending remains under budgetary restraints. And high taxes, abetted by persistent although reduced inflation, continue to hold down increases in real consumer income, or buying power.

U. S. exports have fallen short of expectations. To have rapid export growth, the rest of the industrial world must enjoy vigorous economic expansion. Major foreign countries have actually experienced slower economic recovery than the U. S.

A dramatic change in this trend is unlikely. The Organization for Economic Cooperation and Development predicts that in the 1977 economic climate its industrial nation members will experience a more modest expansion than they had in 1976. In that event, foreign demand for U. S. exports will probably contribute little to our own business recovery.

Brighter news comes from two of our biggest industries-- automobiles and homebuilding. They ended the year on an improving note, with anticipation of additional modest gains in 1977.

Consumers have been receptive to all but the small model cars. More mortgage money is available, and mortgage rates are lower than they have been in some time. Nevertheless, the high level of housing starts, auto sales, and current price tags argue against being overly optimistic in these important sectors of the economy.

All in all, it does not appear that business activity will grow vigorously this year. On the contrary, it would be surprising if the average growth rate for 1977 hits 6 percent.

Can fiscal stimulus be used as a tool to push the economy ahead? Probably not, unless it has that effect in the very near future. As a matter of fact, I feel strongly that too much public discussion

has centered on unreasonably simple and temporary solutions such as fiscal stimulation and not enough on the long-term structural economic problems.

The amount of thrust that can be provided by this method will depend, of course, on final legislation. Earlier experience has shown that a one-time tax rebate or temporary tax cut energizes consumer spending more quickly than do permanent reductions in tax rates. However, consumers tend to save much of their tax rebates, thus diminishing fairly quickly any economic invigoration. Apparently, permanent reductions in tax rates have a longer-lasting effect on the economy than do rebates.

The impact of any tax reduction proposal also depends on its division between individuals and businesses. Tax relief for business would help corporations reduce their borrowings. This would tend to retard interest rate increases. That might be one way to help speed up the economy with a minimum of friction in financial markets.

There have been many different spending proposals, ranging from small increases for public service programs to bold energy development and mass transit schemes. Prudence demands guarding against spending programs that might create future inflationary difficulties. Enactment of major expenditure programs should include methods for readily phasing them out.

A fiscal program is difficult to put together that attacks lagging growth in the short-run but remains compatible with the longer-range goals of reducing inflation and unemployment. The budget deficit for the current fiscal year already amounts to about \$60 billion, not including fiscal stimulus. A larger deficit, in turn, forces the government to borrow more money, which could lead to higher interest rates and, perhaps, to higher inflation.

Nevertheless, a modest, well-designed tax cut could do much to preserve confidence. And confidence is crucial to economic health.

In the past, uncertainties about government policies have inhibited spending and investment decisions and curtailed plans of businessmen and consumers alike. We need additional consumer confidence and spending to encourage the building of new facilities by businessmen in anticipation of future sales. Quite clearly, more money spent on productive capacity, in turn, helps generate new jobs.

In considering the best remedy for the economic ills, we must not overlook this vital consideration: Fiscal remedies used to attack economic ills of the '40s and '50s may not work equally well in the '70s. The economic conditions of the past few decades have changed significantly. To ignore these changes is to close our eyes to the fact that traditional policies and programs may no longer fit the circumstances.

Cheap and abundant energy is a thing of the past. We can no longer think in casual terms about its cost and availability. Though this nation produces 60 percent of its oil domestically, it must still buy oil from the OPEC countries. There is an overriding need to pay more and more attention to energy conservation and the development of new energy sources.

In addition, our productive capacity is less adequate for the long pull than it was in earlier decades. There have been warnings about investing too little of the nation's GNP in new productive capacity. Some critics feel that much current capital spending to reduce pollution rather spending to increase capacity will mean lags in economic growth.

Starting a new paper or chemical facility is a lengthy procedure. Shortages of basic materials can develop faster than we might realize. An example of reduced capital spending is our present medical and health care. Although they have expanded, they do not meet current demands, much less show promise of meeting future needs.

A change in our economic structure and labor force to an increasingly more service-oriented nation is unfolding. Women and young people are looking for work at an ever-rising rate. A college diploma is no longer the passport to a good job. The government is employing a larger segment of the population.

A listing of major economic changes, of course, includes inflation. In the '50s and '60s, annual price increases of 3 percent

or more were unusual. In 1976, there was a 5-percent rise--actually a big improvement over the double-digit 1974 experience, but still too high.

Increased productivity, scaled-down wage increases, and reduced food prices helped in 1976. It seems unlikely that there will be a significant easing in price increases in 1977. On the contrary, farm and food prices have stopped declining and industrial commodity prices have increased.

How then should the Federal government in its longer-term policies and programs react to these changes in the economic environment? Reliance on measures pinpointed to the particular problems to be corrected would appear to be a common-sense approach.

General monetary and fiscal measures have a role to play; they are appropriate for economic stabilization. But they don't correct fundamental ills or specific problems. They are, in fact, as evidenced these past ten years, capable of aggravating problems, particularly in the economic environment of the '70s.

Monetary and fiscal stimulation have the effect of increasing the demand for goods and services. That's well and good when resources are plentiful and prices are falling. But the amount of new machinery and facilities put in place has been below normal for years, although at the moment most industries have capacity to spare.

In today's setting, it is important that the amount of fiscal stimulus eventually provided is no greater than the amount businessmen expect. Greater stimulus might raise the spectre of accelerating inflation, causing businessmen to delay their investment plans.

There is the possibility that unexpected private demand pressures combined with too much fiscal stimulus might create excess demand. Similarly, inflationary supply pressures may confront us more quickly than we now perceive. These pressures can develop from many different sources: Shortages of skilled labor, limits on general industrial capacity, or shortages of particular commodities or sectors, such as health care or energy.

Should consumer spending speed up quickly, and investment in new facilities continue to lag, shortages and bottlenecks could develop quickly. Inflation could accelerate as a result of corporate pricing policies, government programs such as higher minimum wages, or faster wage increases.

The necessity of exercising caution in the development of a short-term strategy of stimulation cannot be overemphasized. In developing a longer-term strategy for attacking special problems, targets should be pinpointed.

Special emphasis should be directed toward correcting supply and capacity problems. To induce businesses and residential consumers to conserve energy, we might consider taxes on use, or credits for nonuse.

We might consider tax credits for encouraging new technology and the use of new energy systems. We might refine our present tools, or develop new ones, for reducing unemployment in the inner cities, especially among black teenagers.

Tax incentives for business and a lower minimum wage for youths than for adults deserve a closer look. Programs that discourage persons from performing productive work should be corrected. And we should reexamine our tax system with the view of stimulating capital investment.

In summary, despite all the handwringing, the economy is in fairly good shape. Prospects are good that President Carter and the Congress will keep fiscal policy initiatives within reasonable bounds. One reason for moderate pessimism is the risk that government will do too much and ignite new inflationary expectations.

With the economic momentum emerging in late 1976, even a moderate dose of stimulus does not appear necessary. On the other hand, the still cautious state of business confidence suggests a little insurance may be justified.

So 1977 should be a reasonably good year. And if the new leadership renews business and consumer confidence, there will be extra reason for encouragement.