STRATEGIES FOR THE ECONOMY

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by

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Discussing the economy with this audience is 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 energy program. But we can focus on other longer-run economic problems and reflect on the last year and a half.

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 Administration proposed a two-year $31.2-billion plan. But when it became obvious that the economy did not need a strong shot in the arm, the President appropriately withdrew the controversial $50 tax rebate plan from the fiscal package.

Signals from the economy show that the pause, or lull, ended in late 1976. Production rebounded. Retail buying strengthened. Home-building picked up. 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 told a different story. Frigid weather and natural gas shortages resulted in production curtailments. Employment and income weakened. Higher heating bills and price hikes on fresh fruits and vegetables chilled people's pocketbooks.

Once the weather warmed up and more natural gas became available, the cold-weather related losses in the economy were quickly made up. In fact, the economy bounced back very rapidly this spring. Production as well as employment expanded at a vigorous rate. Personal income recorded an accelerated rise, and residential construction activity surged beyond expectations.

Consumer demand has been the main support of this growth. Consumers showed a strong interest in large American and smaller sized foreign cars and bought homes at very rapid rates. Home sales in some parts of California became so torrid that people literally stood in line to buy homes and sell them at a profit before they even moved in. So, real growth the first part of this year seems to be advancing at a higher than 6-percent clip President Carter set as a goal for 1977.

Although the economy's recent pace has been rapid, many expect the economy in the second part of this year to grow at a slower rate. Some, indeed, expect another lull, or pause, close to last year's proportions.

It's difficult to predict these things. Based on my reading of April and May figures, the increase in business activity has already slowed down. Incoming data suggest reduced gains in consumer spending and unanticipated increases in inventories. Consumer sentiment, or confidence, though still high, seems to have slipped. The dramatic decline in the saving rate raises further doubts about the outlook for consumer spending. So, consumers will probably be cautious in their spending habits during the months ahead.

Some construction 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 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 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.

In a broader context, the whole merchandise trade position of this country gives me much concern. Imports to this country have increased at an alarming rate. Soaring oil imports and rapid increases in the importation of automobiles, textiles, coffee, and television sets have been mainly responsible. So, instead of a $9-billion trade deficit recorded in 1976, the first quarter of 1977 produced a record deficit of nearly $28 billion, annual rate. Our trade deficit is expected to stay high in the last half of 1976, though it may diminish somewhat from its current level.

All in all, it appears that business activity in this country will not be booming the rest of this year, though I expect some expansion. Mortgage money is available, and mortgage rates are still lower than they have been in past years.

Can we expect capital spending to keep the economy moving? Probably, though all the evidence on this point is not yet in. Corporations have stepped up equipment buying, but they have also shown reluctance to move ahead with major projects. Industry's plans, as reported in the latest surveys, indicate that total business capital spending, adjusted for inflation, will continue to increase during 1977. The amount of this increase remains in doubt on account of the uncertainties created by the energy proposals. Yet I am modestly optimistic about the outlook for capital spending. Recent contract figures for industrial building show more strength than they have in some time.

What are the prospects for solving the unemployment problem? A further reduction in the nation's unemployment rate, now at around 7 percent, is likely with further economic growth. But a quick reduction to the 5-percent level of 1974 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 many employment-seeking persons.

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

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.

A fiscal program is difficult to put together that attacks what was thought to be lagging growth in the short-run but remains compatible with the longer-range goals of reducing inflation and unemployment. The Administration must be congratulated for withdrawing the $50 tax rebate, which would have widened the deficit by another $10 billion. Still, the Administration expects for the 1978 fiscal year a budget deficit amounting to $58 billion. Such a large deficit, in turn, forces the government to be a heavy borrower, which could lead to higher interest rates and, perhaps, to higher inflation.

A smaller deficit, on the other hand, could do much to increase 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. There is an overriding need to pay the closest attention to energy conservation, the development of new energy sources, and the resolution of the energy shortage.

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 than 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. But there has been a significant rise in prices this year. Farm, food, and industrial commodity prices have climbed rapidly. The rise in wholesale prices has been double-digit. And consumer prices have increased at a 9-percent annualized rate.

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 many industries have capacity to spare.

We have avoided many economic excesses of the past. Overborrowing and overlending are still not present on any major scale today. Exuberance and speculation have been pushed back by conservatism and caution. So the usual signs of a new boom-and-bust cycle are not what they were several years ago.

Also, the Federal Reserve kept credit readily available. And, partly because of a lower inflation rate (compared to past years), interest rates are still up only fractionally from their lowest point in four years.

Yet, some clouds have recently appeared on the horizon. Speculation in housing and land seems to be on the rise. There is a renewed inflationary psychology present that goes beyond the consumer and wholesale price indexes.

The Federal Reserve has recently given a small sign of leaning against the wind, warning against a recurrence of overlending and earlier excesses and acting to avoid an overabundant money supply. The degree of credit tightening undertaken by the Federal Reserve has been on a small scale so far.

In today's setting, it is also important that the fiscal stimulus 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 or restraint 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 should consider taxes on use, or credits for nonuse. We should 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 continuing, monetary and fiscal moderation appears necessary.

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