

REMARKS OF MR. ROBERT P. MAYO
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AT THE UNIVERSITY OF OREGON
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THE FIGHT AGAINST INFLATION

I APPRECIATE YOUR WILLINGNESS TO COME OUT TO THIS MEETING THIS AFTER-NOON. I'M SURE MOST OF YOU HAVE ALREADY HEARD ALL THE SPEECHES YOU WOULD LIKE ABOUT INFLATION--ESPECIALLY FROM POLICYMAKERS. I CAN PROBABLY ASSUME YOU HAVE HEARD OR READ VIRTUALLY EVERYTHING THAT IS KNOWN, ASSERTED OR SPECULATED ABOUT INFLATION, ITS CAUSES AND CURES. YOU UNDOUBTEDLY AGREE WITH SOME VIEWS, DISAGREE WITH OTHERS, AND HAVE YOUR OWN POSITION.

BUT EVEN THOUGH I MAY BE ABLE TO ADD VERY LITTLE NEW OR CONVINCE YOU TO TAKE A DIFFERENT POSITION, I CANNOT BACK AWAY FROM THE TOPIC OF INFLATION. TO ME AND TO MANY, MANY AMERICANS, INFLATION HAS BECOME THE MOST IMPORTANT ECONOMIC FACT AND ECONOMIC ISSUE OF OUR LIVES IN TODAY'S ENVIRONMENT. IT DESERVES--INDEED REQUIRES--OUR CONTINUED CONCERN.

INFLATION, WHILE TECHNICALLY AN ECONOMIC PROBLEM, HAS TAKEN ON ALMOST AN AMORAL DIMENSION. IT--INFLATION--HAS RESULTED IN A BREAKDOWN OF OUR ECONOMIC VALUES. IT HAS AFFECTED OUR CONTRACTS, DISTORTING DIFFERENCES BETWEEN PROMISES AND PERFORMANCE. AND IT HAS DONE THIS IN A MAJOR WAY. THE DIFFERENCES BETWEEN PROMISES AND PERFORMANCE AT AN ANNUAL RATE OF INFLATION OF 10 PERCENT MEANS A DOUBLING OF NOMINAL VALUE IN LITTLE MORE THAN SEVEN YEARS.

IT--INFLATION--HAS DISTORTED RELATIONSHIPS AMONG INDIVIDUALS AND GROUPS IN OUR SOCIETY. IT PRODUCES GAINS FOR THOSE LUCKY ENOUGH TO PREDICT FUTURE INFLATION, POSITIONED SO AS TO SAFEGUARD THEIR INTERESTS OR WELL ORGANIZED ENOUGH TO OFFSET THE ONSLAUGHT OF PRICE INCREASES. IT PRODUCES LOSSES FOR THOSE UNABLE TO DO SO.

~~IT--INFLATION--~~DISTORTS OUR RELATIONSHIP WITH OUR GOVERNMENT AND UNDERMINES ITS VERACITY. IT ALLOWS POLITICIANS TO MAKE PROMISES THAT CANNOT BE KEPT IN REAL TERMS. IT BECOMES A MEANS OF PROMOTING CHANGES IN OUR POLITICAL, SOCIAL AND POLITICAL INSTITUTIONS THAT CIRCUMVENTS THE DEMOCRATIC PROCESS. IT BECOMES A MEANS OF TRYING TO EXPLOIT LABOR'S MONEY ILLUSION--THAT IS, LABOR'S RESPONSE TO A LARGER WAGE OFFER THAT WILL SUBSEQUENTLY BE ERODED BY INFLATION. (INTERESTINGLY, THE ATTEMPT TO TRADE ON THE MONEY ILLUSION HAS BACKFIRED BECAUSE WE ARE NOT MONEY BLIND.)

~~IT--INFLATION--~~DISTORTS BUSINESS ACCOUNTING AND CASH FLOWS. IT HAS RESULTED IN CAPITAL FORMATION TOO WEAK TO SUSTAIN THE ECONOMY AT FULL EMPLOYMENT WITHOUT THE CRUTCHES OF A FEDERAL DEFICIT.

BUT I DON'T NEED TO BELABOR THE EVILS OF INFLATION. YOU KNOW THEM AND HAVE FELT THEM. I AM UNDOUBTEDLY EMPHASIZING THESE CONCERNS TO THE WRONG GROUP. BUT I CANNOT HELP BUT THINK AT TIMES THAT THERE MUST BE MANY WHO DO NOT SHARE MY CONCERNS. IF THERE WERE, WE WOULD HAVE MADE MORE PROGRESS IN THE FIGHT AGAINST INFLATION.

BUT, OBVIOUSLY, THERE IS ANOTHER REASON FOR OUR FAILURE. OUR ECONOMIC POLICIES HAVE NOT MEASURED UP. OUR SOLUTIONS MAY BE INEFFECTIVE OR SIMPLY WRONGHEADED. AND AS ONE OF THOSE ON THE FIRING LINE, I HAVE FELT MY SHARE OF THESE ARROWS.

PART OF OUR PROBLEM IN FIGHTING INFLATION, AND PROBABLY THE MOST COMMON ONE TODAY, IS THE ATTEMPT TO IDENTIFY PARTICULAR PRODUCTS, SERVICES OR COMMODITIES AS CULPRITS. INFLATION, IT IS ARGUED, IS CAUSED BY AGRICULTURE, LABOR, MEDICAL SERVICES, OPEC OR EVEN HOUSING. THE ATTEMPT TO BLAME INFLATION ON A PARTICULAR SECTOR AFFECTED BY A CHANGE IN DEMAND OR SUPPLY CONDITIONS IS PATENTLY NONSENSE.

TAKE RESIDENTIAL HOUSING, FOR EXAMPLE. RESIDENTIAL HOUSING COSTS HAVE BEEN LOOKED UPON AS ONE OF THE MAJOR CULPRITS IN THE INFLATION PICTURE OF THE PAST TEN YEARS. IT IS CERTAINLY TRUE THAT HOME OWNERSHIP COSTS HAVE RISEN FASTER THAN THE CONSUMER PRICE INDEX DURING THE PERIOD, ON AVERAGE ABOUT 2 1/2 PERCENT A YEAR FASTER. YET PARADOXICALLY, HOME OWNERSHIP HAS PROVEN IN RECENT YEARS TO BE THE BEST SINGLE MEANS THAT THE AVERAGE FAMILY COULD USE TO PROTECT ITSELF AGAINST INFLATION. AS YOU KNOW, THIS PROTECTION HAS OPERATED IN TWO WAYS. FIRST, AS PRICES OF EXISTING HOMES HAVE INCREASED, OWNERS' EQUITIES IN THOSE HOMES HAVE INCREASED EVEN FASTER. A RECENT PURCHASER WHO STILL OWES 90 PERCENT OF THE PURCHASE, OFTEN SEES HIS EQUITY MORE THAN DOUBLE IN A YEAR. SECOND, SINCE THE MAJOR OUT-OF-POCKET COST OF HOME OWNERSHIP IS THE MONTHLY MORTGAGE PAYMENT, THE HOMEOWNER SEES A MAJOR DRAIN ON HIS POCKET-BOOK FROZEN AT A LEVEL CORRESPONDING TO PRICES OF ONE, TWO, OR TEN YEARS AGO, GIVING HIM MUCH MORE LEEWAY TO COPE WITH THE RISING PRICES OF ALL THE OTHER PURCHASES IN HIS BUDGET. THE BOOMING HOUSING MARKET, IN ALL ITS ASPECTS--USED HOMES, CONDOMINIUMS, NEW RESIDENCES--IS AMPLE EVIDENCE THAT THE AVERAGE AMERICAN RECOGNIZES AN OPPORTUNITY WHEN HE SEES ONE. ONCE EXPECTATIONS OF CONTINUING INFLATION HAVE PERVADED THE PUBLIC MIND, THE INCREASE IN DEMAND FOR HOME OWNERSHIP BECAME ENORMOUS. AND THAT DEMAND ITSELF PROVIDED FURTHER PRESSURE TO DRIVE HOME PRICES UP.

BUT PROTECTION AGAINST INFLATION, IMPORTANT A MOTIVE AS THAT IS, HAS NOT BEEN THE SOLE SOURCE OF THE INCREASING DEMAND FOR HOUSING. AS A NATION, WE HAVE BECOME WEALTHIER OVER THE PAST TEN YEARS. PER CAPITA PERSONAL INCOME HAS GROWN AT AN AVERAGE RATE OF 8.1 PERCENT A YEAR SINCE 1969, A HAIRSBREADTH FASTER THAN THE AVERAGE GROWTH IN THE HOME OWNERSHIP COMPONENT OF THE CONSUMER'S PRICE INDEX. THIS MEANS THAT PER CAPITA PERSONAL INCOME GROWTH HAS OUTPACED THE INCREASE IN MANY OTHER PRODUCTS IN THE CONSUMER'S MARKET

BASKET, LEAVING STILL MORE FUNDS FOR HOME OWNERSHIP. WHILE IT IS TRUE THAT, IN THE PAST YEAR, INCOME GROWTH HAS FALLEN BEHIND THE RATE OF HOME PRICES, THIS IS LIKELY TO BE ONLY A TEMPORARY PHENOMENON.

FURTHER PRESSING ON THE MARKET FOR NEW HOMES IS THE CONTINUING HIGH RATE OF NEW HOUSEHOLD FORMATIONS, AND THE AGING OF THE POST-WAR BABY BOOM GENERATION INTO THE MORE PRODUCTIVE AGE RANGES OF THE LABOR FORCE. TODAY'S 30-YEAR OLDS WERE BORN IN 1949. THERE WILL BE ABOUT 1.7 MILLION NEW HOUSEHOLDS ESTABLISHED THIS YEAR, A SIMILAR NUMBER NEXT YEAR, SLOWLY TAPERING DOWN TO 1.5 MILLION A YEAR BY THE MID-1980s. THESE YOUNG HOUSEHOLDS WILL BE SEEKING HOMES. MORE AND MORE THEY WILL BE TWO-INCOME FAMILIES. THEY WILL HAVE FEWER CHILDREN THAN THEIR PARENTS HAD AND THEY ARE WAITING LONGER TO HAVE THEM. WITHOUT THE COSTS OF RAISING YOUNG CHILDREN AND WITH TWO INCOMES, THEY CAN AFFORD HOMES SOONER AND THEY ARE BUYING. THE CURRENT SLOWDOWN IN HOUSING STARTS CAN ONLY RESULT IN EVEN STRONGER HOUSING DEMAND LATER. WHEN ECONOMIC CONDITIONS RECOVER FROM WHAT NOW IS EXPECTED TO BE A RATHER MILD RECESSION, HOUSING STARTS FIGURES ARE LIKELY TO ONCE AGAIN START SETTING RECORDS.

OF COURSE, NOT ALL OF THE PRESSURE ON HOUSING PRICES HAS COME FROM THE DEMAND SIDE. COSTS HAVE CLEARLY ESCALATED. AND THE STEADY INCREASE IN COSTS IS NOT JUST A PHENOMENON OF THE PAST TEN YEARS. THE AMERICAN APPRAISAL Co.'s COST INDEX IS STILL BASED ON 1913. A HOUSE BUILT AT A COST OF \$100,000 THIS SPRING WOULD HAVE COST LESS THAN \$4,500 SHORTLY BEFORE WAR BROKE OUT IN EUROPE IN 1914. BUT IT IS TRUE THAT ALL COSTS--MATERIALS, LABOR, LAND, AND OVERHEAD--HAVE RISEN OVER THE PAST DECADE, AND PARTICULARLY STEEPLY IN THE HIGHER INFLATION ENVIRONMENT OF THE PAST TWO TO THREE YEARS. THE PRICE OF LUMBER HAS BEEN AMONG THOSE THAT HAVE DRAWN ATTENTION. THE AVERAGE NEW HOME BUYER, AS HE WATCHES HIS HOME BEING ERECTED, IS PROBABLY AWED BY THE LARGE AMOUNT OF LUMBER, PLYWOOD AND OTHER WOOD PRODUCTS THAT GO INTO ITS CONSTRUCTION.

WHEN A CAREFUL LOOK IS TAKEN AT THE INDIVIDUAL COSTS WHICH TOTAL UP TO THE COST OF THE HOUSE, WOOD PRODUCTS, AND LUMBER IN PARTICULAR, MAKE UP A SMALLER AND SMALLER SHARE OF THE TOTAL. THE AVERAGE HOME SOLD IN 1977, AT A PRICE OF \$54,200, CONTAINED ABOUT \$4,300 IN LUMBER, ABOUT 8 PERCENT OF THE SELLING PRICE. IN 1973, WHEN THE AVERAGE HOUSE WAS SELLING FOR \$35,500, IT CONTAINED ABOUT \$3,100 WORTH OF LUMBER, OR NEARLY 9 PERCENT. THUS LUMBER PRICES HAVE NOT BEEN A MAJOR FACTOR IN EITHER THE TOTAL COST OF HOMES FOR THE LAST SEVERAL YEARS NOR OF THE PRICE INCREASE. LUMBER COSTS WENT UP \$1,130 WHILE THE HOUSE PRICE WENT UP \$18,700. GIVEN THE PRESENT ENERGY SITUATION, IT SEEMS LIKELY THAT LUMBER COSTS WILL PLAY A PROGRESSIVELY DECREASING ROLE IN THE TOTAL SELLING PRICE OF A HOME. REQUIREMENTS FOR SUBSTANTIALLY MORE INSULATION, MORE EXPENSIVE, ALBEIT MORE EFFICIENT HEATING SYSTEMS AND APPLIANCES, SOLAR WATER AND HOME HEATING, AND INCREASINGLY MORE EXPENSIVE LAND--ALL OF THESE ARE LIKELY TO ADD COSTS MORE RAPIDLY THAN INCREASING LUMBER COSTS.

THIS IS NOT TO SAY THAT THE PRICE OF LUMBER, OR FOR THAT MATTER, THOSE OF ALL THE PRODUCTS PRODUCED FROM OUR FOREST RESOURCES ARE NOT IMPORTANT IN THE TOTAL PRICE BEHAVIOR OF OUR ECONOMY. AS LONG AS INFLATION PERSISTS, THE FOREST PRODUCTS INDUSTRY WILL BE SUBJECTED TO UPWARD COST PRESSURES FOR LABOR, EQUIPMENT, LAND RIGHTS, AND ENERGY COSTS. THE INDUSTRY'S PROBLEMS ARE COMPLICATED BY THE UNCERTAINTIES OF WHAT THE FINAL RESOLUTION WILL BE FOR USAGE AND LOGGING PROCEDURES OF THE FEDERAL GOVERNMENT'S FOREST LANDS. I AM SURE YOU OUT HERE ARE MUCH MORE AWARE OF THAT ASPECT OF THE PROBLEM THAN WE ARE IN THE PRAIRIE FARMLANDS SURROUNDING CHICAGO. WHAT I WOULD STRESS IS THAT INFLATION IS NOT JUST RISING OIL PRICES OR LOGGERS' WAGES. IT IS PERVASIVE THROUGH ALL SECTORS OF THE ECONOMY--BE IT HOUSING, FOREST PRODUCTS, OR LUMBER--NO ONE IS GOING TO SEE COST PRESSURE RELIEF UNTIL THE GENERAL LEVEL OF PRICE INCREASES IS SLOWED.

BEFORE I BEGAN TO TALK ABOUT HOUSING AND LUMBER, I HAD ASSERTED THAT IT IS ERRONEOUS TO CONSIDER A SINGLE SECTOR, WHETHER HOUSING, OIL OR FOOD, AS THE SINGLE SOURCE OF INFLATION. BUT WHAT THEN IS THE SOURCE? MANY FACTORS HAVE BEEN SUGGESTED. SOME ASSERT THAT MONEY, AND NOTHING BUT MONEY, CAUSES INFLATION. SOME ASSERT THAT THE ENTIRE GAMUT OF GOVERNMENT POLICIES --FROM DEFICIT SPENDING TO PROTECTIONISM TO MINIMUM WAGES TO FARM PRICE SUPPORTS TO ENVIRONMENTAL AND SAFETY REGULATIONS--CAUSES INFLATION. SOME ARGUE THAT IT IS SOCIAL PRESSURES, COMPETITION FOR THE NATIONAL PRODUCT, AND A REVOLUTION OF ASPIRATIONS THAT CAUSE INFLATION.

THE FIRST VIEW HOLDS THAT THE CENTRAL BANK IS RESPONSIBLE FOR INFLATION. THE SECOND, IN EFFECT, ARGUES THAT HIGH TAXES OR THE GOVERNMENT DEFICIT IS RESPONSIBLE. THE THIRD MAKES THE PEOPLE RESPONSIBLE--OR SPECIFIC GROUPS, SUCH AS LABOR UNIONS, CONSUMER ADVOCATES, OR ENVIRONMENTALISTS. YOU MIGHT FIND IT INTERESTING TO TRY TO MATCH THIS LINEUP OF RESPONSIBILITY WITH SOME OF THE ARGUMENTS YOU HAVE HEARD.

EACH OF THESE POSITIONS ON INFLATION HAS MANY SUPPORTERS. EACH POSITION IS ARGUED FORCEABLY IN PUBLIC DEBATE. INDEED, EACH APPROACH HAS SOME LOGIC BEHIND IT. AND EACH SUGGESTS A SOLUTION OR A SERIES OF ACTIONS TO CONTAIN AND CORRECT THE INFLATIONARY BURDEN--FROM STABLE MONEY GROWTH, TO PROPOSITION 13 TYPE CORRECTIONS, TO WAGE AND PRICE CONTROLS, OR TO MANY OTHERS. THERE APPEARS TO BE AS MANY SOLUTIONS AS THERE ARE COMPLEXITIES TO THE INFLATIONARY PROBLEM.

IN THE FINAL ANALYSIS, HOWEVER, ONE HAS TO ADMIT THAT INFLATION IS A MONETARY PHENOMENON. CONTINUED HIGH RATES OF MONEY GROWTH INEVITABLY DO LEAD TO HIGHER RATES OF INFLATION. THE HISTORICAL RECORD ON THIS IS CLEAR. BUT LET'S BE CAUTIOUS ABOUT EMBRACING TOTALLY AND EXCLUSIVELY THE SINGLE CAUSE EXPLANATION FOR INFLATION AND THE IMPLIED SINGLE SOLUTION TO INFLATION.

NOT THAT LONGER RUN MODERATION IN MONEY GROWTH IS UNNECESSARY IF WE EVER DO GET INFLATION UNDER CONTROL. IT CERTAINLY IS. BUT TO RELY SOLELY ON THE CENTRAL BANK TO WRESTLE WITH INFLATION WITHOUT CORRECTING THE STRUCTURAL DEFECTS IN OUR ECONOMIC SYSTEM OR PUBLIC POLICY PROCESSES WILL NOT, IN AND OF ITSELF, PRODUCE MAXIMUM ECONOMIC WELFARE FOR OUR SOCIETY. IN OTHER WORDS, MAINTAINING MODERATION IN MONEY GROWTH WILL NOT BY ITSELF INSURE THE LEVELS OF EMPLOYMENT AND THE RATE OF GROWTH THAT THE SOCIETY MAY DESIRE. AND THIS IS ONE OF THE DANGERS IN TOUTING A SINGLE-CAUSE, SINGLE-SOLUTION MONETARIST APPROACH TO INFLATION. IT CAUSES PEOPLE TO STEP BACK WITH A YAWN AND SAY THAT THIS TAKES CARE OF THE WHOLE PROBLEM OF MAINTAINING ACCEPTABLE ECONOMIC PERFORMANCE--NOT JUST INFLATION.

INDEED, YOU ALL ARE AWARE THAT MONETARY POLICY HAS NEVER BEEN GIVEN A SINGLE OBJECTIVE BY CONGRESS--TO MAINTAIN STABLE PRICES. IT HAS ALSO BEEN CHARGED WITH RESPONSIBILITY FOR EMPLOYMENT, ECONOMIC GROWTH AND BALANCE OF PAYMENTS CONSIDERATIONS. THIS HAS MEANT THAT MONETARY POLICY HAS FOUND ITSELF FREQUENTLY IN BETWEEN THOSE THAT URGE MAXIMUM SHORT-TERM ECONOMIC STIMULATION SO THAT MATERIAL PROGRESS WOULD BE ACHIEVED AND MORE JOBS CREATED AND THOSE THAT URGE THAT PURCHASING POWER BE LIMITED SO THAT INFLATION WOULD BE DISCOURAGED AND EVENTUALLY BROUGHT UNDER CONTROL. NOT SURPRISINGLY THEN, MONETARY POLICY HAS NOT BEEN ABLE TO FOCUS SINGLE-MINDEDLY ON ONE ECONOMIC OBJECTIVE, NO MATTER HOW DESIRABLE, WHEN THE SOCIETY HAS MULTIPLE GOALS. IN A DEMOCRATIC SOCIETY THE POLICY OPTIONS HAVE TENDED TO BE COMPROMISES.

BUT ALSO IMPORTANT HAS BEEN THE FACT THAT MONETARY POLICY HAS BEEN PUSHED OFF OF NON-INFLATIONARY PATHS BY DEVELOPMENTS ELSEWHERE--DEVELOPMENTS OR ACTIONS, I MIGHT ADD, THAT REPRESENT MORE THAN JUST THE MULTIPLICITY OF GOALS. THEY REFLECT THE INABILITY OF OUR POLITICAL PROCESS TO RECONCILE THE MULTIPLE GOALS.

ONE EVIDENCE OF THIS HAS BEEN THE EXPANSION OF GOVERNMENT EXPENDITURES ON GOODS AND SERVICES WITH AN ACCEPTANCE OF DEFICITS. THERE IS A DIRECT EFFECT OF GOVERNMENT PURCHASES AND DEFICITS ON INFLATION BUT IT IS SMALL RELATIVE TO THE METHOD OF FINANCING. THE DEFICIT, HOWEVER, HAS AN INDIRECT EFFECT OF SOME SIGNIFICANCE. THE NATURE OF OUR POLITICAL PROCESS LOWERS THE LIKELIHOOD OF A NON-INFLATIONARY MONETARY POLICY WHEN THE FEDERAL GOVERNMENT HAS LARGE AND PERSISTENT BORROWING REQUIREMENTS. A FAILURE OF THE CENTRAL BANK TO MEET THESE NEEDS WOULD HAVE EFFECTS ON PRIVATE SECTOR BORROWING, EXPENDITURES AND ULTIMATELY EMPLOYMENT THAT WOULD BE UNACCEPTABLE TO THE POLITICIANS AND, IN THE LAST ANALYSIS, TO THE PUBLIC. THEREFORE, IT IS APPROPRIATE TO ARGUE THAT FISCAL POLICY STRIVE TO ATTAIN A BALANCED BUDGET GOAL SO AS TO ELIMINATE THIS INFLUENCE TENDING TO MORE INFLATION.

FURTHER, THERE IS A MORE GENERAL PUBLIC RESPONSIBILITY, WORKING THROUGH OUR POLITICAL PROCESS, TO ORDER OUR PUBLIC NEEDS WITHIN THAT BALANCED FRAMEWORK SO THAT WE CAN MEET OUR GOALS OF MAXIMUM ECONOMIC WELFARE AND PERSONAL FREEDOM. AND NOT ONLY MUST WE ORDER OUR PRIORITIES, WE MUST UTILIZE THE BEST APPROACHES IN MEETING THEM CONSISTENT WITH MAXIMIZING OUR LONG-TERM NEEDS AND NOT BE BLINDED BY DIVERSIONARY SHORT-TERM GOALS.

INFLATION IS USUALLY THE LAST LINK IN A LONG CHAIN OF WELL-MEANT ACTIONS. THE BENEFITS OF A TAX CUT, OF INCREASED PUBLIC SPENDING, OF A FASTER RATE OF MONEY GROWTH, MAY BE FELT WITHIN A FEW WEEKS OR QUARTERS. THE PENALTY IN TERMS OF INFLATION COMES LATER, PERHAPS A COUPLE OF YEARS LATER, PERHAPS EVEN LATER. INFLATION IS THE LONG-RUN CONSEQUENCE OF SHORT-RUN EXPEDIENCIES. WE ARE NOW EXPERIENCING THE LONG-RUN CONSEQUENCES OF THE SHORT-RUN POLICIES OF THE PAST. THE CONSEQUENCES ARE AS UNACCEPTABLE AS RAIN ON WEEKENDS. AND JUST AS DIFFICULT TO CHANGE!

THE PROBLEMS CONFRONTING US HAVE BEEN SO SEVERE THAT PERHAPS WE ARE NOW READY TO TAKE A LONGER TERM VIEW OF THE PROBLEMS AND THEIR SOLUTIONS. WITH NEGATIVE REAL ECONOMIC GROWTH IN PROSPECT FOR THIS YEAR AND WITH INFLATIONARY PRESSURES INTENSE, I HOPE THAT THIS CAN BE A WATERSHED YEAR FOR ECONOMIC POLICYMAKING. THE TRADITIONAL NATIONAL RESPONSE TO A WIDELY HELD VIEW OF THE PROSPECT OF A SLACKENING IN ECONOMIC EXPANSION OR RECESSION (COMMONLY THOUGHT OF AS TWO QUARTERS OF NEGATIVE REAL GROWTH) WOULD BE TO REVERSE THE ECONOMIC POLICY GEARS, BACKING OFF FROM IMMEDIATE DEEP CONCERN ABOUT INFLATION AND STARTING TO PUMP UP THE ECONOMY AGAIN. BUT, HOPEFULLY, THE REACTION OF ECONOMIC POLICY TO OUR REACHING THE WATERSHED IN ECONOMIC PERFORMANCE WILL BE SIGNIFICANTLY DIFFERENT THIS TIME.

OPPOSITION TO "KNEE-JERK" POLICIES--SWITCHING TO STIMULATIVE GOVERNMENT POLICIES WHENEVER SLOWER ECONOMIC GROWTH SEEMED LIKELY--HAS, OF COURSE, EXISTED FOR A LONG TIME. BUT IT HAS TAKEN THE PRESSURE OF PERSISTENT INFLATION, GATHERING MOMENTUM FOR WELL OVER 10 YEARS NOW, TO BRING THIS NATION TO THE POINT OF MAKING A SIGNIFICANT AND NECESSARY CHANGE IN ITS THINKING ABOUT ECONOMIC POLICY. BUT HOPEFULLY THAT CHANGE IS OCCURRING. IT WAS EVIDENT IN THE ECONOMIC REPORT OF THE PRESIDENT ISSUED EARLY THIS YEAR AND SEEMED TO BE SUPPORTED PRIOR TO THE LAST OPEC OIL PRICE HIKES.

THE BIGGEST DANGER IS, OF COURSE, THAT OUR POLITICAL DETERMINATION WILL WEAKEN. UNFORTUNATELY, I SEE LITTLE REASON TO EXPECT CONGRESSIONAL SUPPORT (OR FOR THAT MATTER ADMINISTRATION SUPPORT) IF A MUCH SHARPER CONTRACTION THAN NOW GENERALLY FORECAST WERE TO OCCUR. A DEEP, SHARP RECESSION WOULD BRING SWIFT CONGRESSIONAL REACTION WITH GREATER GOVERNMENT STIMULATION AND EVEN GREATER INFLATION.

EVEN IF THERE IS NEGATIVE GROWTH IN THE ECONOMY THIS YEAR, I MUST CONFESS I DO NOT EXPECT TO SEE ANY SWEEPING STRIDES IN WINDING DOWN INFLATION. THE PRESIDENT'S WAGE AND PRICE STANDARDS PROGRAM CONTINUE TO BE TESTED,

LABOR CONTRACT BARGAINING IS SURE TO BE VIGOROUS. EVEN THOUGH FOOD PRICE INCREASES HAVE BEEN MODERATING A LITTLE AND MONETARY POLICY IS CURRENTLY DIRECTED TOWARD MODERATE MONEY GROWTH, THE UNFORTUNATE RISE IN OPEC OIL PRICES, AND THE CONTINUED PASS-THROUGH OF HIGHER PRICES FOR IMPORTS, MAKE THE CHANCES OF SIGNIFICANT MODERATION IN OVERALL PRICE RISES SMALL INDEED.

UNDOUBTEDLY, ONLY MODEST IMPROVEMENT IN REDUCING THE RATE OF INFLATION ARISING FROM SLOWER ECONOMIC GROWTH CAN WEAKEN THE RESOLVE OF CONGRESS AND TEST ITS PATIENCE. IT WILL BE DIFFICULT FOR THE LESS COURAGEOUS TO CONTINUE TO ACCEPT SLOWER GROWTH AND ATTENDANT UNEMPLOYMENT INCREASES--IN THE ABSENCE OF DRAMATIC PRICE EFFECTS. NEVERTHELESS, SUCH A COURSE IS NECESSARY.

THERE IS, OF COURSE, A POSSIBILITY THAT INFLATION RATE REDUCTIONS WILL COME SOMEWHAT MORE RAPIDLY AS CONSUMERS AND BUSINESS FIRMS BEGIN TO LOSE SOME OF THEIR CYNICISM AND ACCEPT THE VIEW THAT INFLATION WILL, INDEED, BE CONSTRAINED. THE HIGH RATE OF INFLATION HAS GENERATED RESPONSES BY INDIVIDUALS AND INSTITUTIONS THAT PERPETUATE A RISING SPIRAL EVEN IN PERIODS OF ECONOMIC SLACK. IF EXPECTATIONS CHANGE ABOUT THE FUTURE COURSE OF PRICES --EVEN SLIGHTLY--BEHAVIOR WILL ALSO BE MODIFIED. THE SOONER WE HAVE CONFIDENCE THAT A LOWER INFLATION RATE IS IN PROSPECT, THE SHORTER THE PERIOD TO BRING US CLOSER TO REASONABLE STABILITY.

THE WATERSHED IN ECONOMIC POLICY IN 1979 MAY NOT BE DRAMATIC BUT IT COULD BE EXTREMELY IMPORTANT. IF WE CAN HOLD OUR GROUND--STARTING NOW--IF WE CAN MAINTAIN REASONABLE FISCAL AND MONETARY RESTRAINT, WE SHOULD BE ABLE TO MAKE SUBSTANTIAL PROGRESS TOWARD A MORE STABLE, LESS INFLATIONARY ECONOMY FOR THE YEARS AHEAD. WE MUST DO IT. THE FUTURE OF OUR COUNTRY--OUR ECONOMIC FREEDOM AND OUR PERSONAL FREEDOM--DEPENDS ON IT.