Bumper Sticker

~~Speech~~ 1/18/94
Cleveland
Chapter
Ohio CPA's

Usually, in the early months of a new year, it is a time to access where things stand, before trying to look ahead & make plans

4 years ago--just weeks after the tumbling of the Berlin wall; collapse of the so-called IRON CURTAIN
-worry over response of the Soviets

3 years ago, January 1991--Iraq in Kuwait, Gulf War
-Scuds, biological, chemical
-oil shock

2 years ago--Gorbechev taken captive by bumbling thugs in an attempted coup; Yeltsen--new ruler
-disintegration of Soviet Union
-concerns about civil war, starvation

A year ago--
-in U.S., election resulting in change in White House for first time in 12 years

Now, an NBA season w/o Michael
In the Autumn of 1993--Michael Jordan retired

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To Gerry
For your file.

Date 1/20/94
From Pat

During the past year--

- several pieces of legislation submitted that would affect the Fed
    - Check collection
    - S & R
    - Fed Pres. & FOMC
    - B.O.D.
    - disclosure of deliberations & decisions of FOMC meetings

What has given rise to this?

Inflation
bond yields, mortgage rates
home affordability
existing home sales
housing starts
domestic auto sales
business investment spending
capital goods spending/exports
productivity in manufacturing sector
real output
employment, unemployment

Congress--mad & determined to put a stop to it

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Economically efficient market for goods and services:

then--town, vil~~l~~age, city

now--the world

Measuring ~~Sources of~~ Wealth of Nations:

Beginning of the 20th century: tons of things and # of things

Natural resources

Russia, Brazil, Africa

End of the 20th century:

knowledge/information based technologies

Switzerland, Japan, SE Asia

Contest of Ideas: Socialism/Dictatorship Capitalism/democracy

Watershed Decades

1930s--Dawn of the age of Socialism

Depression--massive increase in the intrusion of Govt. : Nationalization/Regulation

Mussolini

1980s--Golden Age of Capitalism

Economic Regeneration:

Three basic components

deregulation

denationalization/privatization

tax reduction/reform

Macroeconomic stability

reduced amplitude of fluctuations of:

inflation

interest rates

exchange rates

output growth

employment/unemployment

"narrower corrider" of economic activity

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- when decisions are based on the expectations of higher inflation than actually occurs
    - --ex post real interest rates are too high;
    - --ex post real tax rates are too high;
    - --ex post real wages are too high

- higher taxes, debt-servicing burdens, and wages tend to get built into cost structures that cannot be passed on to consumers, so earning are impaired
    - --lower returns on capital means less savings and investment;
    - --end result is slow growth and lower standards of living

<u>In spite of 13 years of a downward trend of inflation</u> --

- surveys
- yield curves
- refinancing
- debt issuance

<u>In 1950s and early 1960s</u> --

- households and businesses made decisions in the expectation that <u>increases</u> in inflation and interest rates were <u>temporary</u> -- they would go back down

<u>For past 20 to 25 years</u> --

- households and businesses have made decisions based on expectations that <u>declines</u> of inflation and interest rates are <u>temporary</u> -- they are expected to go back up

New world monetary regime
Dollarization of world

<u>Over 22 years ago -- August 15, 1991</u> --

- end linkage of dollar to gold
- pure fiat currency
  --dollar had been "worth" 1/20 oz. of gold
  --then, 1/35 oz. of gold
  --now, whatever it will buy

- never has been a "phoenix currency"

<u>Bretton Woods</u> -- gold/$

- non-political discipline on monetary authorities
  --political "cover" for other national leaders
  --constraint on U.S. -- "policing the policeman"

<u>Post-Bretton Woods</u> --

- international competing currencies
  --judgments of central bankers

<u>Stable Standard of Value essential to economic development</u> --

- roulette wheel/baby, 18 years
- inches in yard
- feet in mile
- ounces in pound or gallon

<u>Expectations</u> about future purchasing power of national currencies affect resource utilization and future standards of living --

- at present, households and businesses appear to be expecting future inflation to be higher than it is the intention of monetary policymakers to produce

If we could wave a magic wand --

- get people to base decisions on expectation that in the future the purchasing power of the currency will be the same as today, and policymakers will act to ensure that outcome, economic well-being would be maximized

Reasons for optimism --

- globalization of goods markets
  - --financial markets
  - --asset markets

- stock market crash of October 1987

- pneumonia

- financial market vigilantes

- dollarization of the world

- regional/sectoral booms and busts

- bicoastal economy
  - --agric/manufacturing/energy
    versus
  - --defense/aerospace/commercial real estate/
    financial services

Summary --

The challenge is to restore credibility to the idea that the price level will be stable over long periods of time. The ideal is a monetary regime that would have the credibility of the pre-World War I gold standard without the destabilizing elements that led to its demise. A nation's currency is its unit of account or standard of value. Optimal resource allocation overtime -- which will maximize standards of living -- requires minimal distortions arising from unexpected changes in the value of money. Establishment of such an environment requires a clear and credible commitment, backed by incentives and constraints, to maintaining the purchasing power of the dollar -- not simply in the short-term, but over the long horizon.