PLANNING FOR ADEQUATE JOBS

Remarks by

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Nobody is very happy with the performance of the U. S. economy these days. You may be surprised to hear that that's as true within the ranks of the Federal Reserve as it is in the Congress or the labor movement. What worse combination of economic ills could one imagine than peak levels of unemployment at the same time that consumers are confronted with rising costs at the supermarket, the gas station, and indeed almost anywhere he turns.

The funny thing, though, is that while we all agree on the complaints, we each have different ideas as to who or what's to blame, and therefore what ought to be done to set things straight. Let me say right off the bat that I don't have a pat solution. I certainly don't think the problem has been excessive increases in wages in the last couple of years. The fact is, as you know, that real take-home pay actually fell in much of 1973 and 1974. At the same time, I find it hard to swallow the cries of outrage from organized labor that "for the second time since 1969, the Federal Reserve System ... has brought recession to the American economy and unemployment to millions of workers."

Search for a villain may relieve frustrations, and pointing the accusing finger may distract attention from one's own problems, but they seldom help in finding where truth lies. In this case, I must admit, the "truth" -- that is, the causes of stagflation -- may be so complex -- and controversial -- that name-calling is as close as we'll come to meaningful dialogue, to our mutual disadvantage.

Let me say a word, though, about how the Fed thinks we got into our present mess.

"Our economy today is suffering from a serious recession. That such a development would take place, sooner or later, has long been clear to students of business cycles, who watched with increasing concern the gathering momentum of inflation. This round of inflation got under way in our country in 1964; its pace quickened in subsequent years with the piling up of Federal Deficits and the devaluation of the dollar, and it became dangerously rapid in 1973 and 1974. As is characteristic of the late stages of an inflationary boom, speculative activities flourished, particularly in real estate markets, while industrial efficiency languished . . . .

"As a result of these developments, our nation's productive capacity suffered a setback. Consumer purchasing power eroded; the real value of the wages, savings deposits, pensions, and life insurance policies of the American public diminished. Corporate profits declined -- a fact that received little notice because of accounting techniques that had been designed for inflation-free times. Financial markets underwent exceptional stresses and strains, and interest rates soared to record levels. In short, inflation led to this recession, as it has done time and again in the past . . . ."[1]

Whether or not you and I agree on how we got into the present mess, the real question is what should we do now, to help bring down unemployment without restimulating inflation. First of all, I hope you'll agree that policy makers are in a box, a dilemma. It's not as though

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[1]Arthur F. Burns, <u>Statement before the Committee on Banking, Housing and Urban Affairs</u>, February 25, 1975, pp. 1-2.

there's an obvious path for monetary policy to follow, and we -- the Fed -- are pigheadedly ignoring it. Frankly, it's a balancing act, and while one can argue about whether we should lean more toward ease or toward tightness (trying first to define those terms so at least we know what we're arguing about), the fact is that we could damage recovery by leaning too far in one direction or the other.

Now there's a certain devil theory about the Federal Reserve that says we rub our hands and cackle with glee every time interest rates rise. I'm sure I can't persuade you away from that notion if you want to believe it, but I'll deny it nevertheless. The fact is that we're very concerned about the long-run implications of high interest rates for sustained economic growth in this country. One can hardly pick up a paper these days without reading about a threatened shortage of capital investment to sustain economic activity and employment over the years ahead. I want to come back to this point in a minute, but there are a few observations I'd like to make about "high interest rates" first.

1) The Fed can control -- however imperfectly -- the <u>supply</u> of money in the economy, but we can't control the demand for money. Since interest is the price of money (or credit), and that price is set by the <u>interaction</u> of supply and demand, the Fed can influence interest rates but we can't control them for any prolonged period.

2) If, despite what I just said, the Fed decided to try

to hold interest rates down below market levels, the only way we could do it would be either by supplying money endlessly, with the result that the cost of money would stay down for awhile, but the cost of everything else would rise; or by rationing money (i.e. allocating credit), which some people have suggested, but which the Fed has resisted strongly.

3) What are "high" interest rates, anyway? If inflation is eating 8¢ out of every dollar you and I earn or save over a year, is an 8% interest rate high? Again, the fact is that inflation has not only outpaced earnings growth over the past couple of years, but it has also reduced the real purchasing power of savings accounts as well. Who's going to be satisfied with a zero real return on his savings for very long?

4) While one can raise questions about how competitive financial markets are in this country (I happen to think they're pretty competitive by and large), it's a fact that interest rates behave more like commodity prices than like wages. For example, if the Fed tightens up on the supply of money and interest rates go up, they can and do come back down again -- whereas I'm not aware of many cases where wages, once they've risen, fall back again. This difference may sound

trivial, but it has serious implications for whether controls are needed, or would even work, in curbing high interest rates.

Apart from this philosophizing, I happen to believe that the Fed can and should provide adequate financing to sustain the recovery that is now underway. As you know, the Fed has stated to Congress that our target for monetary growth over the coming year is a range of 5 to 7-1/2 percent, and I personally favor the upper end of that range. That doesn't mean that interest rates -- especially short-term interest rates -- won't rise over the months ahead. Indeed, if the pace of economic expansion is as strong as I hope and expect it will be, some increase seems almost inevitable as credit demands pick up. But much more important in determining the trend in long-term rates -- the mortgage rate, for example -- will be the pace of inflation itself. On that score, you're perhaps as qualified to take a guess as I.

Even as we work our way out of the present morass (and I think we will), there are other questions for the longer-run economic outlook that deserve your consideration. Assuring adequate jobs is not just a concern of the present recession, it is a challenge for the years ahead. Some people argue that the best way to assure continued economic growth is by establishing some sort of formalized planning structure for the national economy. This concern comes from all segments of the economic community and appears to transcend the traditional labor-business factions. For example, Senator Humphrey is the author of a bill to promote balanced national growth and development which, he states, is "the single most important piece of legislation in my twenty-five years of public service."

Likewise, Leonard Woodcock is cochairman of the Initiative Committee for National Economic Planning which, on February 27 of this year, issued a statement entitled, "For a National Economic Planning System." In part, this statement read "It should be clear that the planning office would not set specific goals for General Motors, General Electric, General Foods, or any other individual firms. But it would indicate the number of cars, the number of generators and the quantity of frozen foods we are likely to require in, say, five years, and it would try to induce the relevant industries to act accordingly."

Frankly, I'm not convinced that we need new governmental planning structures. Instead, I still hold out hope that we can make better use of our existing policy tools. And here I'd like to quote rather extensively from a study called "capital needs in the seventies." As I mentioned earlier, this is a hotly debated subject these days, and there's a good deal at stake -- for jobs, for interest rates, for our entire economic outlook.

Here's what the authors say:

"During the postwar period the American economy has demonstrated an unparalleled capacity to produce goods and services of all kinds. In spite of periods of inflation and occasional recessions, living standards have risen almost continuously. At the same time the volume of saving has provided for a continuous upgrading and renovation of industrial and commercial capital as well as for new plants and equipment for a growing work force. In the public sector the demands of a vastly expanded educational system have been met with little strain and 40,000 miles of interstate highways have been built. Nonetheless, capital requirements, far from being satisfied, are greater than ever. The demand for industrial capital is intensified by the need to find new sources of energy, by insufficient capacity in many industries processing raw materials, and by the need for pollution abatement. Widely accepted national housing goals mean that 25 million new homes must be built in ten years. In the public sector large amounts of capital will be required for water treatment and mass transit.

"Adding up the capital necessary for all the projects that either promise a profitable private return or appear high on someone's list of social priorities for the rest of the seventies yields a total of over $2 trillion. Such calculations suggest that, as one writer put it, 'we may not be able to afford the future.'

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"Our answer is that we can afford the future, but just barely. Although investment needs will represent a higher share of total output than in the past decade, they can be met by a moderate adjustment of fiscal and monetary policies.

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"The projected rise in business investment, though not spectacular, implies a significant shift in the long-run direction of fiscal policy. At full employment, private investment is likely to exceed private saving; accordingly, a full employment surplus rather than a deficit will be appropriate."[2]

The message, I hope, is clear. This country is going to have to have large amounts of capital investment over the years immediately ahead, both to meet our needs for energy and environmental cleanup, and to keep a growing labor force employed. There are essentially two ways to try to assure that investment: 1) through new apparatus of national planning (i.e. government allocation of resources); or 2) through rates of return (profits and interest) adequate to attract funds into savings and investment.

While I don't rule out further experimentation in the area of economic planning, previous efforts do not seem to me to augur well for expecting much pay dirt. In contrast, I think one of the most hopeful developments of the last couple of years has been the establishment within the Congress itself of Budget Committees that are to set limits on expenditures, tied to expected receipts and the expected state of the economy. If we can muster the political guts to use the federal budget not only as a counter cyclical tool -- which it certainly should be -- but also as a means for closing the gap between needed investment and private savings, we should be able to avoid a severe capital shortage, high interest rates and the bureaucratic constraints of planning that both labor and business resent. And, wonder of wonders, we might even reach that promised land of high employment, low inflation and indeed low interest rates that -- believe it or not -- we all are seeking.

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[2] Barry Bosworth et al., capital needs in the seventies, Brookings Institution, Washington, D.C., 1975, pp. 1-3.

Certainly, if we don't learn to manage better, we can only expect -- and maybe in some sense, deserve -- more of what we've already got: namely, trouble! Budget deficits to fight recession and high interest rates to fight inflation are a sure prescription for low investment and a sluggish economy.

There is no sure or easy cure, despite the promises one sometimes hears. For example, I was interested to read in this morning's paper a column by a professor of early childhood and elementary education, and an urban planner, who offered the following advice:

"It is possible to guarantee to every person willing and able to work a job at decent wages. While over the long run this can best be achieved by comprehensive economic-planning measures, in the short run public-service employment programs could drive the unemployment rate down to 3 percent in 18 months at a net cost of only $10.7 billion annually . . .

"And it is also possible to achieve the goal of full employment without intensifying our inflation problem -- indeed, full employment, with increased production of goods and services, would be anti-inflationary. The endemic national problem of inflation, however, can probably only be resolved if the guarantee of a job is linked with additional measures such as price and profit controls and credit and wage guidelines."[3]

I leave you to judge whether that's your picture of paradise. It's not mine. And rather than chase that kind of mirage, I'd rather slog through some difficult times, now, in hopes of laying a firm basis for prolonged economic growth in the years ahead.

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[3]Alan Gartner and Marjorie Gellermann, "Everything but jobs for the jobless", Minneapolis Tribune, September 9, 1975, p. 4A.