The Economic Outlook

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Just so we don't lose sight of how significant that part of the outlook is, let me simply remind you that we are now in the fourth year of what has really been an extraordinary expansion on the part of our economy. Since the beginning of the expansion, a little over three years ago, the economy has produced 8 million new jobs — an unprecedented figure in the recent history of this country. Last year alone, the economy produced 4 million new jobs. We now have a higher percentage of the population working than we've had at any time since we've been keeping those records. And we expect to see continued–but–modest improvements in those dimensions as we move through 1978.

Unfortunately, there is also some bad news. And some very disturbing news relating to the outlook for inflation. In my judgment that outlook is bad and getting worse. All you have to do is read the paper on almost any day and you'll see something that indicates that either prices have gone up or some action has been taken which is going to result in prices going up somewhere down the road. And what I'd like to do is talk for a few minutes about why that's the case and then make some suggestions on (1) what we can't do about it, (2) what we should do about it, and (3) what we are likely to do about it.

Now, lest there be any question as to the seriousness of the problem, let me remind you that at the moment we are faced with the following facts: the consumer price level rose at significant rates in January and February; the wholesale price index rose at even faster rates; the dollar is taking a pounding internationally; the stock market, on average, seems to be down; and we see increasing questions in the minds of consumers and business people about the outlook for inflation.

In my judgment, there are several basic reasons why we face these disturbing facts. First of all, we have allowed significant inflationary pressures to develop in the economy. A year ago the standard economic forecast went something like this: unemployment is high, but coming down. Inflation is also high, but coming down. Now the standard economic forecast says unemployment is a little lower and likely to go a little lower; inflation is still high and is likely to go higher. That's a significant change in the way most people, including the vast majority of professional economists, view the economic outlook. And there is really no mystery in my mind as to why the outlook for inflation has changed.

First of all, we have run, and are continuing to run, a huge government deficit. We now face, in the fourth year of the economic expansion, an officially projected deficit of 60 billion dollars. Unofficially, we're starting to hear numbers closer to $70 or $80 billion. As this is the fourth year of an economic expansion, we ought to be getting smaller rather than larger government deficits. In my mind there is no way — given the current economic situation — that we can run a $60 or a $70 or an $80 billion deficit without serious inflationary consequences.

The second thing that has happened is that the Federal Reserve allowed money to grow more rapidly than it should have during most of 1977. We will pay the price for that rapid money growth in terms of 1978 inflation.

The third set of causes, and in a way one of the reasons we've had the first two, is that we have had an ever-increasing demand from all sectors of the country for special governmental assistance to solve their problems. Not only have the requests come, but government has decided to grant far too many of those requests. During the last 9 to 12 months we've had a succession of labor and business and agriculture representatives and representatives of other kinds of groups, asking for government help to solve their particular difficulties. Let's increase the minimum wage, let's increase price supports for farmers, let's restrict imports, let's do this and that and the other thing. And while any one of those things may seem to make sense on an individual basis, when you put them all together, the net consequences are higher domestic prices and a significantly worsened outlook for inflation. And if you want to depress yourself, just write a list of the things that have taken place in the last 9 months that have the kinds of consequences that I've just described. After you have made your list, increase the minimum wage and increase social security taxes and increase supports to farmers and increase restrictions on imports. You'll then understand why the problem is as significant and serious as it is. And, at the moment, we have both political parties falling all over themselves to try and outpromise the other. In that kind of environment the outlook is not reassuring at all.

There is a second basic cause for the economic difficulties that we face. As it seems the government — and maybe the people, although I'm not sure — thinks that we have easy answers to very difficult and complex problems. And we keep trying to solve, through administrative procedures, problems that may not be amenable to that kind of solution. Let me take one example (unfortunately there are many others). The most glaring current example is the question of energy. We keep hearing statements about the fact that we have a serious energy problem. If we would just pass this bill or that bill we could then solve the energy problem, and all those troubles would be behind us.

Unfortunately, in my judgment, we're going about it in exactly the wrong way. And we're going to pay a very heavy price, both in terms of inflation and in terms of other costs to the economy. One of my favorite cartoons had to do with the current approach to the energy problem. I liked it because it showed General Washington at Valley Forge, sitting over his desk. A soldier comes running in and says, "General, we're almost out of firewood." And Washington says, "Quick, tax it." If you think about it, that's precisely what Congress is about to debate in terms of U.S. energy. We're almost out of energy: quick, tax it. I can't think of anything that makes less sense in terms of solving our energy problem. Well, unfortunately, we try to do that in a large number of areas with the consequence that we often end up making things worse rather than better.

If you accept my suggestion that the outlook for inflation is not good, let me suggest a few things that we cannot do to solve the problem. I'd then like to suggest a few things that I think we should do, and then I'll make a forecast as to what we will do.

Things we cannot do to solve the inflation problem: First, we cannot have a tax cut. Now, nobody in this room would like to see taxes lower more than I would.

Unfortunately, if we just reduce taxes without simultaneously reducing expenditures, all we will get for the effort is higher prices. And I don't sense any political will to reduce expenditures at the same time that we reduce taxes. So I'd have to come out against the tax cut, because I'm afraid it's going to be like fool's gold. It will look very good, but it won't be worth anything after it actually takes place. The second thing that we should not do is to have some kind of an "incomes policy" to solve the inflation problem. We hear more and more talk these days about guiding principles or wage and price controls. I'm surprised and disturbed that that kind of talk would be taken seriously such a short time after we have experienced a disaster with wage and price controls. There is no question in my mind that if we try some kind of an incomes policy, it will fail. And we will simply end up with higher prices — not lower prices — because in our attempts to try to restrain or control prices and wages, we will build inefficiencies into the system. Those inefficiencies will result in decreased production and, therefore, the prices for those goods that we do produce will be higher.

Well, we shouldn't have a tax cut and we shouldn't have an incomes policy. A third thing that we should not do is to have an administrative solution to the energy problem. There's just no way that we can make that work. It will lead to shortages, bottlenecks, and, in the long run, higher prices. A fourth thing we should not do is intervene to defend the dollar: it won't work. The only way we're ever going to defend the dollar is to solve our basic inflation problem; then the dollar will take care of itself. The fifth thing we should not do is to continue to give in to repeated requests by business for restrictions on imports, by farmers for increases in the farm program, by labor for increases in wages, and by all of the other groups that are asking for special concessions from our government.

Those are the things we should not do. What can we do? Unfortunately the problem is now so severe that there are no easy solutions — there are just hard solutions. But if we don't accept the hard solutions, the problem will become worse rather than better. There are really three basic solutions to the problem. One is that we must hold the line on government spending. The federal deficit should be coming down rather than going up. Second, we must hold the line on the growth of money and credit. That's our job; I hope we'll do it. And third, as I've already indicated, we cannot continue to give in to special interest pressures that ultimately aggravate the inflation problem in the United States.

What's my forecast as to what we are likely to see? We'll see a tax cut, an incomes policy, and an administrative "solution" to the energy problem. We'll see intervention in the dollar and protection of trade restrictions. All of those very things I fear will make the outlook even more troublesome. The only place that I think we will tend to see moderation will be in the Federal Reserve. I really hope that we will keep the growth of money to moderate proportions and, of course, if we do, and if all these other things take place, then there is only one direction for interest rates to go: up. I hope that if you and I demand actions that are different from those I've predicted today, we can avoid the kinds of consequences that I've outlined. Unfortunately, I'm not very optimistic.