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ROAD TO RECOVERY

Remarks of
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Meeting with Anchorage Community Leaders
and Directors, Seattle Branch
Federal Reserve Bank of San Francisco

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Road to Recovery

I welcome the opportunity to visit Anchorage again, to see for myself how things are progressing in this very progressive state. The newspapers outside frequently tell us about the great prospects of the Sunbelt states of the South and Southwest, but I think that you have even more room for optimism here in the Midnight Sunbelt. Alaska of course has problems of its own, but they are mainly problems of growth, which are far easier to handle than the problems of no-growth of the nation's industrial heartland. I plan to spend most of my time today discussing how we can extricate the U.S. economy from its present difficulties, so that we can restore some of the pioneer spirit that is so evident here and so lacking elsewhere.

Role of Directors

Before I do so, I want to pause to pay tribute to an outstanding group of individuals -- to Anchorage's own Don Mellish and his colleagues on our Reserve Bank's Seattle Board of Directors. The directors at our five offices are involved with each of the major tasks delegated by Congress to the Federal Reserve. That encompasses the provision of "wholesale" banking services such as coin, currency and check processing; supervision and regulation of a large share of the nation's banking system; administration of consumer-protection laws; and in particular, the development of monetary policy. We

ARE FORTUNATE IN THE ADVICE WE GET FROM THEM IN EACH OF THESE AREAS.

OUR DIRECTORS CONSTANTLY HELP US IMPROVE THE LEVEL OF CENTRAL-BANKING SERVICES, IN THE MOST COST-EFFECTIVE MANNER. THIS IS A CRUCIAL ROLE AT THE PRESENT TIME, BECAUSE UNDER THE TERMS OF THE MONETARY CONTROL ACT OF 1980, THE FEDERAL RESERVE IS MOVING INTO A NEW OPERATING ENVIRONMENT. OVER THE PAST YEAR, THE FED HAS BEEN MAKING ITS SERVICES AVAILABLE TO ALL DEPOSITORY INSTITUTIONS OFFERING TRANSACTION (CHECK-TYPE) ACCOUNTS AND NONPERSONAL TIME DEPOSITS, AND THOSE SERVICES ARE BEING PRICED EXPLICITLY FOR THE FIRST TIME.

YET ABOVE ALL, OUR DIRECTORS HELP US IMPROVE THE WORKINGS OF MONETARY POLICY. AS ONE MEANS OF DOING SO, THEY PROVIDE US WITH PRACTICAL FIRST-HAND INPUTS ON KEY DEVELOPMENTS IN VARIOUS REGIONS OF OUR NINE-STATE DISTRICT AND IN VARIOUS SECTORS OF THE WESTERN ECONOMY. OUR DIRECTORS THUS HELP US ANTICIPATE CHANGING TRENDS IN THE ECONOMY, BY PROVIDING INSIGHTS INTO CONSUMER AND BUSINESS BEHAVIOR WHICH SERVE AS CHECKS AGAINST OUR OWN ANALYSES OF STATISTICAL DATA. THEIR ADVICE HAS BEEN ESPECIALLY VALUABLE TO US THESE LAST SEVERAL YEARS, WHEN WE'VE HAD TO FACE PROBLEMS OF HIGH INFLATION, HIGH INTEREST RATES, AND SHARP FLUCTUATIONS IN BUSINESS ACTIVITY.

NATION'S ROAD TO RECOVERY

WE NEED ALL THE ADVICE WE CAN GET, BECAUSE WE ARE MIRED IN ONE OF THE WORST RECESSIONS OF THE PAST GENERATION -- OR

PERHAPS I SHOULD SAY SERIES OF RECESSIONS, BECAUSE AFTER SEVERAL UPS AND DOWNS, THE NATION'S OUTPUT IS JUST ABOUT WHERE IT WAS THREE YEARS AGO. PART OF THE PROBLEM LIES WITH THE 150-PERCENT OIL-PRICE SHOCK OF THE 1979-80 PERIOD, WHICH ACTED AS A GIANT SALES TAX, RAISING PRICES AND DRAINING OFF PURCHASING POWER THAT OTHERWISE WOULD HAVE BEEN AVAILABLE FOR BUYING OTHER GOODS AND SERVICES. BUT THE MAJOR CAUSE OF THE PROBLEM MUST BE INFLATION ITSELF, WHICH FOR A DECADE HAS UNDERMINED BUSINESS AND CONSUMER SPENDING PLANS, LEADING TO A DECLINE IN PRODUCTIVITY AND IN THE GENERAL HEALTH OF THE U.S. ECONOMY. IN ADDITION, THE SUCCESSFUL ANTI-INFLATION PROGRAM OF THE PAST SEVERAL YEARS, WITH ITS TIGHTENING OF MONETARY POLICY, HAS CLEARLY ACHIEVED ITS GOAL BUT AT THE TEMPORARY COST OF A REDUCTION IN BUSINESS ACTIVITY.

HEADLINE WRITERS AND NEWSCASTERS HAVE HAD A FIELD DAY REPORTING GLOOMY BUSINESS STATISTICS THIS SPRING. AFTER AN ALMOST STEADY DECLINE, INDUSTRIAL PRODUCTION IS RUNNING ABOUT 7½ PERCENT BELOW A YEAR AGO, AND THE NATION'S INDUSTRIAL PLANT IS WORKING AT ONLY 71 PERCENT OF CAPACITY. MORE THAN 1½ MILLION JOBS HAVE DISAPPEARED SINCE LAST SUMMER, AND ROUGHLY 9½ PERCENT OF THE NATION'S LABOR FORCE IS NOW UNEMPLOYED. EVEN WORSE, THE JOBLESS RATE MIGHT REACH DOUBLE-DIGIT LEVELS, SINCE IT NORMALLY KEEPS RISING FOR SOME MONTHS EVEN AFTER A BUSINESS RECOVERY GETS UNDERWAY. THESE AND OTHER STATISTICS SUPPORT THE WIDESPREAD BELIEF THAT THE SITUATION IS WORSENING, AND THAT THERE IS NO END IN SIGHT FOR THE RECESSION.

IF PAST HISTORY IS ANY GUIDE, HOWEVER, THE BUSINESS UPTURN SHOULD BE ABOUT TO BEGIN -- OR MAY ALREADY HAVE BEGUN. IN THE FIRST QUARTER, SALES TO FINAL CONSUMERS (AFTER ADJUSTING FOR INFLATION) SHOWED THE FIRST SIGNIFICANT RISE OF THE PAST YEAR. THIS SHOWED THAT HOUSEHOLDS, BUSINESSES AND GOVERNMENTS ARE STILL IN THE MARKET FOR MANY ITEMS -- DESPITE THE PESSIMISM THEY SHOW IN THEIR REPORTED BUYING PLANS. AND THESE HIGHER SALES, BY EATING INTO INVENTORIES, HAVE HASTENED THE DAY WHEN PRODUCTION TURNS UP AGAIN, AND THEREBY BOOSTS THE NEED FOR LABOR, MATERIALS, AND MACHINERY. THE FIRST-QUARTER STATISTICS, INDEED, WERE DOMINATED BY THE SHARPEST INVENTORY CUTBACK IN HISTORY -- $40 BILLION, AT AN ANNUAL RATE. FOR EXAMPLE, AUTO DEALERS' NEW-CAR STOCKS HAVE DROPPED FROM A 107-DAY SUPPLY TO A 66-DAY SUPPLY SINCE THE FIRST OF THE YEAR.

RESTOCKING OF INVENTORIES WILL GIVE A STRONG BOOST TO THE ECONOMY, ALTHOUGH BUSINESSES OF COURSE WILL RESTOCK ONLY IF THEY SEE SUFFICIENT STRENGTH IN HOUSEHOLD DEMAND. THE DEMAND IS THERE, HOWEVER, AND WILL BECOME EVEN MORE EVIDENT AFTER MIDYEAR. EMPLOYMENT LEVELS REMAIN HIGH, BUYING POWER IS GROWING, CREDIT USAGE REMAINS LOW IN RELATION TO INCOMES, AND HOUSEHOLD LIQUID ASSETS ARE AT RECORD LEVELS. HOUSEHOLD BUYING POWER WILL SOON GROW EVEN MORE, BECAUSE THE 10-PERCENT TAX REDUCTION AND 7½-PERCENT BOOST IN SOCIAL-SECURITY BENEFITS SCHEDULED FOR JULY 1 WILL ADD AT LEAST $45 BILLION MORE TO AFTER-TAX INCOMES.

THE STRONGEST BOOST, HOWEVER, HAS COME FROM THE RECENT SHARP DROP IN THE INFLATION RATE. (AFTER ALL, EACH PERCENTAGE-POINT DECLINE IN THE INFLATION RATE REPRESENTS ABOUT TWO-THIRDS AS MUCH OF A BOOST TO REAL HOUSEHOLD INCOME AS WE'LL RECEIVE FROM THE MIDYEAR TAX CUT.) CONSUMER PRICES ROSE AT ONLY A 2½-PERCENT RATE OF INCREASE DURING THE FIRST QUARTER -- ONLY ABOUT ONE-FIFTH OF THE AVERAGE PACE DURING THE 1979-80 PEAK YEARS. MEANWHILE, WORKERS COVERED BY MAJOR UNION AGREEMENTS ARE RECEIVING DEFERRED INCREASES OF MORE THAN 6 PERCENT THIS YEAR -- THE LARGEST GAIN IN OVER A DECADE. THUS, WITH WAGES REFLECTING EARLIER CONTRACT AGREEMENTS, THE RECENT DROP IN THE INFLATION RATE CLEARLY HAS GIVEN A SUBSTANTIAL (AND UNEXPECTED) LIFT TO PEOPLE'S INCOMES.

CAN THE GOOD NEWS ON INFLATION CONTINUE? PART OF THE RECENT PRICE IMPROVEMENT REFLECTED THE RECESSION-INDUCED GLUT IN THE WORLD'S PETROLEUM MARKETS. WITH RECOVERY, THE GLUT COULD DISAPPEAR AND PRICES COULD START RISING AGAIN -- BUT PROBABLY AT A MUCH SLOWER PACE THAN BEFORE, GIVEN THE LESSONS IN CONSERVATION WE HAVE ALL LEARNED. ANOTHER PART OF THE PRICE IMPROVEMENT CAN BE TRACED TO A WEAKENING OF WAGE AND SALARY PRESSURES, IN CONTRAST TO SUBSTANTIAL INCREASES NEGOTIATED IN EARLIER YEARS. IN THE FORD AND GENERAL MOTORS SETTLEMENTS, LARGE LAYOFFS AND MOUNTING LOSSES HAVE PRODUCED WAGE FREEZES AND LESS FREQUENT

COST-OF-LIVING INCREASES -- AND MODEST WAGE SETTLEMENTS ARE LIKELY TO CONTINUE IN THE LIGHT OF THE STRUCTURAL PROBLEMS IN AUTOS AND OTHER INDUSTRIES.

MOST OF THE FAVORABLE INFLATION NEWS, HOWEVER, CAN BE TRACED TO THE FEDERAL RESERVE'S POLICY OF MONETARY DISCIPLINE, SINCE INFLATION IS PRIMARILY A MONETARY PHENOMENON. THE NARROW M-1 MEASURE OF MONEY -- CURRENCY PLUS ALL TRANSACTION (CHECKABLE) DEPOSITS -- HAS DECELERATED SIGNIFICANTLY IN RECENT YEARS, TO FIVE-PERCENT GROWTH IN 1981 FROM 1978'S EIGHT-PERCENT GROWTH. SINCE MONETARY CHANGES AFFECT PRICES WITH ROUGHLY A TWO-YEAR LAG, WE'RE NOW SEEING THE FAVORABLE RESULTS OF THE MONETARY SLOWDOWN ADOPTED SEVERAL YEARS AGO. SO IF THE FED MANAGES TO STAY WITHIN ITS M-1 TARGET-GROWTH RANGE OF 2½ TO 5½ PERCENT THIS YEAR, IT WILL PROVIDE THE ECONOMY WITH ENOUGH ROOM TO GROW, BUT AT A NONINFLATIONARY PACE.

ROADBLOCK TO RECOVERY

STILL, ALL OF THE FAVORABLE FACTORS IN THE OUTLOOK COULD BE NEGATED BY HIGH INTEREST RATES -- THE MOST SEVERE ROADBLOCK TO RECOVERY. TYPICALLY, AT THIS STAGE OF THE BUSINESS CYCLE, WE WOULD SEE A DRAMATIC DECLINE IN INTEREST RATES, PRIMARILY BECAUSE OF THE DISAPPEARANCE OF THE INFLATION PREMIUM FORMERLY DEMANDED BY LENDERS. A FEW STATISTICS WILL SHOW THE VERY CLOSE RELATIONSHIP BETWEEN THE INFLATION RATE AND INTEREST RATES IN RECENT DECADES. BETWEEN 1974 AND 1976, FOR EXAMPLE, THE INFLATION RATE DROPPED FROM 12.2 PERCENT TO 4.8 PERCENT, AND

THE AVERAGE TREASURY-BILL RATE FOLLOWED THE INFLATION RATE DOWN, FROM 7.9 PERCENT TO 5.0 PERCENT. WITH THE NEXT BURST OF RISING PRICES, IN 1979 THE INFLATION RATE REACHED 13.3 PERCENT AND THE AVERAGE T-BILL RATE JUMPED TO 10.0 PERCENT. YET IN CONTRAST, WHEN THE INFLATION RATE DROPPED TO 2.4 PERCENT IN THE FIRST QUARTER OF THIS YEAR, THE T-BILL RATE AVERAGED A VERY HIGH 12.9 PERCENT.

IN A WORD, INTEREST RATES HAVE REACHED RECORD LEVELS WHEN ALLOWANCE IS MADE FOR DECLINING INFLATION. THIS HAS MADE BUSINESS FINANCIAL STATEMENTS VERY DEPRESSING TO READ. FOR EXAMPLE, NET INTEREST COSTS OF NONFINANCIAL CORPORATIONS JUMPED ALMOST BY HALF IN TWO YEARS' TIME, TO $64 BILLION IN 1981. AND HIGH INTEREST RATES HAVE STYMIED THE USUAL CYCLICAL UPTURN, ESPECIALLY IN THE KEY HOUSING INDUSTRY -- WHICH NORMALLY LEADS EACH UPTURN, BUT WHICH CANNOT RECOVER AT TODAY'S MORTGAGE RATES OF 16 TO 17 PERCENT.

AT THE BEGINNING OF THE YEAR, SOME CRITICS ATTRIBUTED THE HIGH RATES TO A SUDDEN AND TEMPORARY UPSURGE IN MONEY GROWTH, WHICH THEY INTERPRETED AS A FEDERAL RESERVE CAPITULATION TO EASY-MONEY PRESSURES GUARANTEED TO UNLEASH A NEW BURST OF INFLATION. THE MONEY-SUPPLY BULGE LATER LEVELLED OUT, AND YET INTEREST RATES REMAINED VERY HIGH. THIS SUGGESTS THAT WE SHOULD LOOK TO ANOTHER EXPLANATION OF THE RATE UPSURGE -- NAMELY, THE UNEXPECTED MAGNITUDE OF FEDERAL DEFICIT-FINANCING PRESSURES.

Deficit Financing: Core of Problem

Quite bluntly, the Federal budget is structurally unbalanced, because of decisions made (or left unmade) in Washington over the past several years. In earlier periods, budget programs projected into the future would always produce declining deficits, and then surpluses, in later years. The current budget program, in contrast, when extended into the future without any further legislative changes, will generate steadily increasing budget deficits for years to come. The causes of this structural disequilibrium are the multi-year tax reductions provided by last year's tax legislation, the rapidly accelerating defense program, and the continued application of cost-of-living escalators to social security and other entitlement programs. And the results, if nothing is done, could be deficits of $180 billion in fiscal 1983 and $220 billion or more in each of the next several fiscal years.

The massive deficits now facing us have kept inflation expectations very high, despite the significant decline in the actual inflation rate over the past two years. The markets obviously fear that, at some point, the Fed will begin to monetize the massive deficits. This would lead to an excessive expansion of the money supply, followed within the next several years by a renewed upsurge of double-digit inflation.

Large Federal deficits in the period ahead certainly would hamper our attempts to stage a sustainable business recovery -- and in the worst case could lead to financial chaos. The Federal Reserve indeed may be able to prevent a significant rise in inflation by allowing only slow growth in the money supply. However, in the face of a relatively low savings rate and huge Federal borrowing, interest rates would stay high and "crowd out" private borrowing. I've been emphasizing this point for the past several years, somewhat like the little boy who kept yelling "wolf." But now we all see that the crowding-out phenomenon has finally arrived, and with a vengeance. The strongest evidence can be found in the home-mortgage market, of course, but other signs are equally evident -- such as the focusing of corporate credit demand on the short-term market, resulting in congestion and high interest rates there.

Let's consider the numbers facing us this year alone. According to Administration estimates, Federal borrowing from the public -- including both deficit financing and "off budget" financing -- could rise from $79 billion in 1981 to $115 billion in 1982. This represents the culmination of an important trend in the nation's financial markets. Federal borrowing amounted to 16½ percent of total funds raised in credit markets during the 1970's, with the share increasing during recession years. But now, according to our staff estimates, the share could approach 32 percent in the 1982

RECESSION YEAR AND 26 PERCENT IN THE 1983 RECOVERY YEAR. CLEARLY, THIS OVERWHELMING FEDERAL PRESENCE IN CREDIT MARKETS HAS AFFECTED THE AMOUNTS AVAILABLE TO FINANCE STATE AND LOCAL GOVERNMENTS, BUSINESS NEEDS FOR PLANT-EQUIPMENT AND INVENTORY -- AND, NEEDLESS TO ADD, THE AUTO AND HOUSING MARKETS. THE ESSENTIAL NEEDS OF THESE CRUCIAL SECTORS OF THE ECONOMY THUS CAN BE MET ONLY AT VERY HIGH LEVELS OF REAL INTEREST RATES.

THE APPEARANCE OF RUNAWAY BUDGET DEFICITS, PERHAPS PREDICTABLY, HAS LED TO A SEVERE REACTION AT THE STATE AND LOCAL LEVEL. AS OF NOW, 31 STATE LEGISLATURES HAVE PETITIONED CONGRESS TO CALL A CONVENTION TO CONSIDER A BALANCED-BUDGET AMENDMENT TO THE CONSTITUTION -- AND THE VOTES OF ONLY THREE MORE STATES WOULD BE NEEDED TO TRIGGER THE CONVENTION CALL. THE OPPONENTS OF THIS APPROACH ARGUE THAT IT WOULD STRAIGHT-JACKET THE FISCAL-POLICY PROCESS. IN ANY EVENT, THE DISCUSSION ABOUT A CONSTITUTIONAL AMENDMENT MAY PLAY A USEFUL ROLE IN GETTING BADLY-NEEDED FISCAL DISCIPLINE. INDEED, BOTH HOUSES OF CONGRESS ARE NOW CONSIDERING BALANCED-BUDGET AMENDMENTS WHICH PARALLEL THE LANGUAGE ADOPTED BY MANY STATE LEGISLATURES.

STILL, THE BEST WAY FOR THE ADMINISTRATION AND THE CONGRESS TO COUNTER THIS SOMEWHAT RIGID APPROACH WOULD BE TO TAKE SPECIFIC ACTION, ON BOTH THE REVENUE AND EXPENDITURE SIDES, TO BRING THE BUDGET CLOSER INTO BALANCE TODAY. IN A RECENT REPORT, THE CONGRESSIONAL BUDGET OFFICE LISTED 69 "BUDGET REDUCTION OPTIONS" AND 40 "OPTIONS TO INCREASE TAX

REVENUES." I'M SURE THAT ADMINISTRATION AND CONGRESSIONAL LEADERS HAVE THOROUGHLY STUDIED EVERY ONE OF THOSE BULLET-BITING OPTIONS. WHAT THEY NEED IS THE POLITICAL SKILL TO ASSEMBLE A PACKAGE OF WORKABLE MEASURES THAT WILL REMOVE THE DEFICIT THREAT TO OUR ECONOMIC AND FINANCIAL WELL-BEING.

AS CENTRAL BANKERS, IT IS NOT OUR RESPONSIBILITY TO PROPOSE SPECIFIC MEASURES TO CLOSE THE FISCAL GAP. HOWEVER, WE HAVE A RESPONSIBILITY TO POINT OUT THE IMPLICATIONS FOR FINANCIAL MARKETS OF THE CROWDING-OUT PROCESS CREATED BY HEAVY DEFICIT-FINANCING PRESSURES. THUS, I BELIEVE THAT PROSPECTIVE FEDERAL BUDGET DEFICITS MUST BE SHARPLY REDUCED IF WE WANT TO SEE MORE REASONABLE LEVELS OF INTEREST RATES.

I FOR ONE HAVE BEEN STRESSING THIS POINT FOR THE PAST YEAR OR MORE. TODAY, HOWEVER, THAT ARGUMENT DOES NOT SIMPLY REPRESENT A FEDERAL RESERVE POINT OF VIEW; INSTEAD, IT HAS COME TO BE ACCEPTED BY POLITICAL FIGURES OF ALL DESCRIPTIONS. TREASURY SECRETARY REGAN HAS MADE THE SAME POINT IN SEVERAL RECENT PUBLIC APPEARANCES -- AND A BIPARTISAN GROUP OF FIVE OF HIS PREDECESSORS RECENTLY ISSUED A STRONG STATEMENT CALLING FOR A SHARP REDUCTION IN THE DEFICIT. THUS, PRACTICALLY EVERYONE RECOGNIZES THAT WE MUST REDUCE DEFICIT-FINANCING PRESSURES TO BRING ABOUT A REDUCTION IN INTEREST RATES -- AND THEREBY SET THE STAGE FOR A HEALTHY RECOVERY IN THE NATIONAL ECONOMY. THE COUNTRY THUS ANXIOUSLY AWAITS A RESOLUTION OF THE BUDGET CONFLICT BETWEEN THE CONGRESS AND THE ADMINISTRATION. THERE ARE SIGNS OF PROGRESS -- THE SENATE

HAS ALREADY PASSED A BUDGET BILL, AND THE HOUSE IS NEGOTIATING ON THE ISSUE. BUT A SPEEDY RESOLUTION OF THE ISSUE IS MUCH TO BE DESIRED.

IMPLICATIONS FOR ALASKA

BEFORE CONCLUDING, LET'S CONSIDER WHAT THESE CONFLICTING DEVELOPMENTS MAY MEAN FOR THE ALASKA ECONOMY. BECAUSE OF HIGH INTEREST RATES AND THE WEAKNESS OF U.S. (AND JAPANESE) HOUSING DEMAND, THE STATE'S LUMBER INDUSTRY IS IN DIFFICULT STRAITS TODAY. BECAUSE OF A RECESSION-CAUSED DECLINE IN DEMAND AS WELL AS THE MASSIVE CANNED-SALMON RECALL, THE STATE'S FISHING INDUSTRY IS SUFFERING ALSO. BECAUSE OF THE SUBSTANTIAL SOFTENING OF ENERGY MARKETS, THE $43-BILLION NATURAL-GAS PIPELINE WILL BE A NON-STARTER FOR AT LEAST THE NEXT SEVERAL YEARS. AND FOR THE SAME REASON, THE STATE GOVERNMENT FACES A ONE-FOURTH REDUCTION IN ITS OIL-BASED REVENUES FOR THE 1982-83 FISCAL YEARS.

TAKEN BY THEMSELVES, THESE SETBACKS MIGHT SUGGEST THAT ALASKA FACES ONE OF THOSE SHARP CYCLICAL DECLINES FOR WHICH THE STATE IS SO WELL NOTED. BUT IN REALITY, ALASKA'S CYCLICAL PROBLEMS SEEM BOUND TO BE OFFSET BY ITS PROCESS OF LONG-TERM GROWTH. THIS STATE, WITH ITS TREASURE TROVE OF RESOURCES, MUST REPRESENT ONE OF THE MOST EXCITING AREAS FOR DEVELOPMENT IN THE ENTIRE NATION -- OR IN THE ENTIRE WORLD. I'M SURE THAT YOU ARE VERY FAMILIAR WITH THE LONG LIST OF PROJECTS IN OPERATION OR ON THE DRAWING BOARD -- THE PRUDHOE BAY AND OTHER NORTH SLOPE OIL FIELDS, THE NATURAL-GAS PIPELINE, THE HUGE

DAMS TO BRING ELECTRICITY TO THE ANCHORAGE-FAIRBANKS CORRIDOR, AGRICULTURAL PROJECTS TO MAKE THIS ONE OF THE NATION'S LARGEST PRODUCING STATES, EXPLOITATION OF OTHER DIVERSE RESOURCES (COAL, COPPER, FLUORITE, TIMBER, FISHERIES ETC.) -- AND ABOVE ALL, THE CREATION OF A MAJOR MANUFACTURING SECTOR BUILT AROUND OIL REFINERIES, PETRO-CHEMICAL COMPLEXES AND THE LIKE.

PROPER DEVELOPMENT WILL TAKE MONEY, OF WHICH PRUDHOE BAY HAS PROVIDED AN AMPLE AMOUNT TO DATE. BUT DEVELOPMENT ALSO WILL REQUIRE WISE POLICIES ON THE PART OF THE STATE GOVERNMENT (WITH ITS ONE-THIRD SHARE OF OIL REVENUES), AND ON THE PART OF THE LARGE MULTINATIONAL CORPORATIONS, THE NATIVE CORPORATIONS, AND (I WOULD HOPE) FROM AN EXPANDING ALASKA-BASED PRIVATE SECTOR AS WELL. THE STATE GOVERNMENT OF COURSE HAS A MAJOR ROLE TO PLAY IN CREATING THE TRANSPORTATION, COMMUNICATION AND OTHER INFRASTRUCTURAL LINKS NEEDED TO TIE THIS VAST STATE TOGETHER. BUT ON THAT FOUNDATION, THE INVESTMENTS MADE BY PRIVATE FIRMS AND NATIVE CORPORATIONS IN PETROLEUM AND OTHER INDUSTRIES SHOULD LEAD TO A NEW ERA OF SUSTAINABLE ECONOMIC MATURITY.

CONCLUDING REMARKS

IN CONCLUSION, I CAN ONLY SAY THAT A STRONG REGIONAL ECONOMY PRESUPPOSES A STRONG NATIONAL ECONOMY, AND THE EVIDENCE REMAINS SOMEWHAT MIXED ON THE LATTER POINT. NORMALLY, WE COULD BE REASONABLY CONFIDENT ABOUT AN UPTURN IN THE NATIONAL ECONOMY, GIVEN THE WORKING-OUT OF THE INVENTORY-LIQUIDATION PROCESS AND THE BASIC STABILITY OF THE HOUSEHOLD SECTOR. THE MOST OBVIOUS

SIGN OF STRENGTH IS THE SHARP DROP-OFF IN THE INFLATION RATE, WHICH HAS STABILIZED REAL INCOMES AND BEGUN TO RESTORE CONFIDENCE TO HOUSEHOLD AND BUSINESS SPENDING/SAVING DECISIONS. NONETHELESS, A SUBSTANTIAL RECOVERY CANNOT BE ASSURED IN THE PRESENT ATMOSPHERE OF HIGH REAL INTEREST RATES.

THE OBVIOUS SOLUTION IS TO CUT PROSPECTIVE DEFICITS VERY SHARPLY. THIS WOULD THEN LOWER LONG-RUN INFLATION EXPECTATIONS -- AND THE RESULT WOULD BE A LOWERING OF LONG-TERM RATES, WHICH WOULD THEN HELP TO REDUCE SHORT RATES AS WELL. IN A WORD, THEN, A SUSTAINABLE RECOVERY REQUIRES A MOVE TOWARD FISCAL DISCIPLINE, AS WELL AS A CONTINUATION OF THE FEDERAL RESERVE'S CURRENT POLICY OF MONETARY DISCIPLINE.

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