THE ECONOMY AND ECONOMIC POLICY

REMARKS BY

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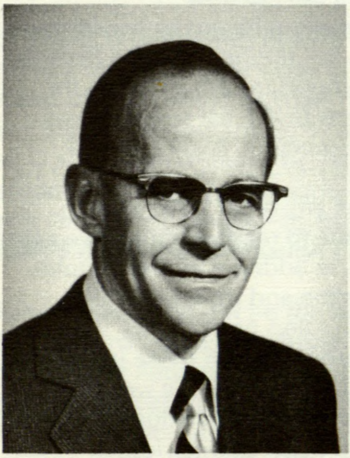
Summary

There's no reason why a boom-and-bust sequence should take place either in Alaska or in the larger national economy, according to Mr. Balles. The base of the Alaskan economy has broadened over the past decade, so that it has the strength to continue moving forward after the completion of the oil-pipeline project. The national economy meanwhile is on a strong expansion path, following the recovery which was brought about by the adoption of stimulative monetary and fiscal policies in early 1975. But the economy must avoid overstimulus in this expansion period, such as may be generated by the massive 1976-77 Federal deficits. Given this inflationary potential of fiscal policy, an independent Federal Reserve policy stance must be maintained.



John J. Balles

I'm glad to have the chance of meeting all you blue-eyed Arabs, as you decide how you're going to spend the money raised by the next OPEC price increase. Perhaps I can interest you in some choice California real estate. Seriously, it's great to visit an area that's wrestling with problems of abundance rather than problems of scarcity. It's a healthier atmosphere, and I'm sure the country could benefit from more cities like Anchorage.

I want to spend some time today telling you how business conditions in the Lower Forty-eight appear to me. In this connection, I'll describe what economic policymakers have been doing to battle the evils of recession and inflation, and what we should do to keep the economy on its present favorable growth path. But first, let me say a few things about the way this visitor from Outside views the booming Alaska economy.

Alaska—Boom But No Bust
Alaska of course is affected by broad national trends, but the pipeline has been by far the most important influence on the state's economy in the last several years. Thanks to the pipeline, Alaska in 1975 showed far greater gains in income and employment than any other state, and it should continue to register impressive gains in 1976. Then, in addition to the stimulus from the pipeline and from Federally-funded construction projects, we should see some improvement in those industries that had been affected by the worldwide recession (such as forest products) and by local problems (such as fisheries).

Even so, there are some clouds behind that silver lining. The labor force has grown even faster than the number of jobs, because of the large influx of jobseekers (many untrained) who have been enticed here by the Prudhoe Bay bonanza. As a result, the state's perennially high unemployment rate may remain burdensome. Then there is the basic question—what can you do for an encore after Prudhoe Bay? An estimated 21,000 people are employed on pipeline-related activities this summer, but what will happen later on when the basic construction work is completed?

Past history would suggest that a bust will follow the boom, but there are enough offsetting factors this time to indicate that the state can continue to maintain a relatively high level of economic activity. One important follow-on project will increase the capacity of the pipeline from its initial flow of 1.2 million barrels a day to its upper level of 2.0 million barrels. The next likely project would involve tapping the natural-gas reserves of the Prudhoe Bay area and the oil and gas reserves of the Outer Continental Shelf. As you've probably noticed, this spring's sale of oil and gas leases in the Gulf of Alaska brought bids of $572 million, surpassing last December's sale of Federal leases off the California coast. The Prudhoe Bay pipeline should supply 12 percent of total U.S. oil requirements by 1978, and the proposed natural-gas pipeline—probably only the first of several—by itself could meet 5 percent of the nation's needs.

The oil boom will not be the last one in Alaska, considering the strong long-term demand for natural resources by the world's industrial powers, and considering Alaska's enormous supplies of such resources as coal, copper, gold, tin and iron ore. Moreover, Alaskans as well as Outsiders participated in the planning of oil exploration, extraction and export, and the outcome thus has been far more satisfactory than with earlier booms. The $900 million received from the 1969 lease sale went to finance the construction and maintenance of public facilities; the $962 million in cash and 40 million acres of land involved in the settlement of the native-claims question helped improve a badly depressed sector of the economy; and the industry's actions in subcontracting and setting up administrative facilities within the state helped guarantee an Alaskan flavor to the oil boom. With the base of the state's economy broadened in this fashion, there's no reason why boom should inevitably lead to bust, as it did so often in Alaska's earlier history.

Strength in the U.S. Economy

Turning now to the business situation in the Lower Forty-eight, let me say that there's no reason why another boom-and-bust sequence should take place there either. We've seen the damage that was done by the worldwide inflationary boom of the early 1970's, with the damage being compounded by wage and price controls which only disguised the distortions created by inflation. Those distortions led inevitably to the worst recession of the past generation, and in the process created a real dilemma for fiscal and monetary policymakers. Our task was two-fold: first, to stimulate the economy sufficiently in the short-run to push it out of recession, and second, to keep the subsequent recovery from generating further inflation in the longer-run.

Some naive observers, at the first onset of recession, announced that it was either a) a replay of the Great Depression or b) the end of the world—and their policy prescriptions ranged from restructuring our financial regulatory system to overturning the entire economic system. Now, I like Hollywood disaster movies as much as anyone else, but I watch them for entertainment and not for instruction. Thus, when we policymakers saw the recession developing, we avoided extreme solutions and instead applied the standard textbook medicine. Indeed, the recovery unfolded on classic textbook lines, just as we expected.

Between late 1973 and early 1975, the real output of the U.S. economy dropped about 6½ percent. Half of the decline was due to cutbacks in spending for autos, homebuilding and business plant and equipment, and the other half was due to cutbacks which businessmen made to bring their inventories back into line with sales. The situation called for a rebuilding of consumer and business spending power, and this was accomplished through a combination of tax cuts and Federal spending programs, accompanied by a moderately stimulative monetary policy. The result, as I said, was a classic textbook recovery, led by a consumer spending upsurge and a restocking of inventories. The economy already has reached new heights in employment and output, and it is making at least some headway against the continuing evils of unemployment and inflation.

The recession and the recovery periods have witnessed an almost unprecedented restructuring of household, corporate and bank balance sheets—and this in turn has built a solid financial base beneath the economy. Consumers, businessmen and bankers have been paying off their debts and rebuilding their cash resources at a faster rate than in any upswing since World War II. This development has reduced the pressure on financial markets to finance the rebound, and the increased liquidity thus offers support for a durable recovery well into 1977 and perhaps beyond. A sustained and durable recovery also seems assured on the basis of other important ongoing developments—such as the general absence of bottlenecks and imbalances in the economy, the success in reducing inflation and inflationary expectations, the substantial gains in income and employment, and the signs of an upturn in business capital spending.

Progress and Policy in '77

Looking towards 1977, most observers project a gain of more than 6 percent in real GNP—the second straight increase of that magnitude following the drop of the 1974-75 period. With the economy growing above its long-term trend in this fashion, unutilized resources should be brought into play and the unemployment rate should decrease—perhaps from today's level of over 7½ percent to about 6½ percent a year from now. Unemployment thus will remain a problem, although the labor market has responded well to expansive monetary and fiscal policies. The anti-recession actions taken a year ago have added almost 4 million people to the job rolls, and have reduced by a million the number of long-term unemployed, the most serious victims of recession. But stimulative policies do not cure the problems of the millions of relatively untrained women and teenagers who have poured into the labor force in recent years. The solution for them is better training programs, a more realistic minimum wage, and the end of restrictive employment practices.

The projected increase in prices next year may be in line with the 5-to-6 percent inflation rate expected this year—far better than the double-digit inflation rate of several years ago, but still not good enough if we hope to achieve our policy goal of sustainable long-term growth. Here, indeed, is the big question mark of 1977. As the economy expands, inflationary expectations could always be rekindled, especially on the part of those who were burned by the price upsurge of several years ago.

In order to keep the economy on the recovery path, the Federal Reserve has fostered a moderate rate of monetary expansion over the past twelve months. During this period, the narrowly defined money supply, M_1, grew about 5¼ percent, while the broader measure, M_2, rose by 10 percent. (M_1 equals currency plus demand deposits, and M_2 equals M_1 plus savings and time deposits other than large time certificates.) But over the longer run, this rate of monetary expansion is too high to be consistent with general price stability. Thus, as Chairman Arthur Burns has noted in several appearances before Congress, money growth targets are being lowered gradually over time.

Fight Against Inflation

Our basic task, then, is to keep from repeating the scenario that led to the destructive inflation of the early 1970's. Everyone has his own pet list of what went wrong at that time, but probably the leading cause was the decade-long string of Federal budget deficits, which in turn consistently pulled monetary policy off course. A look at the numbers will show how fiscal policy generated the imbalances which led to our double curse of inflation and recession. Between 1968 and 1975, per capita take-home pay increased by 72 percent and corporate after-tax profits by 43 percent—which after adjustment for price increases, meant a small increase in household income and an actual decline in corporate income. But at the same time, individual income-tax receipts rose by 78 percent and corporate income taxes by 42 percent—even though Congress *reduced* tax rates in both categories during that period.

Stimulative fiscal policies thus triggered inflationary forces that imposed a serious tax burden upon society, and in the process further limited the spending power of a private sector which had already been squeezed by the worldwide inflation. The end result was a severe recession. Meanwhile, Federal spending programs outran the increased revenues, creating a cumulative deficit of $130 billion over the 1968-75 period. Unfortunately, the trend has now accelerated. Today, we find ourselves with another $130-billion cumulative deficit in the fiscal years 1976-77 alone (including the present transition quarter)—a record bath of red ink in a recovery period where no more than a modest stimulus would normally be called for.

Against this background, let's consider the proposal that the Federal Reserve's independent status be reduced, and that monetary policy be placed under the close control of Congress or the Executive. With all due respect, this sounds like putting the fox in charge of the henhouse. Now, I'm certain that every single person in Washington is dead set against inflation. Yet the evidence before us suggests that the persistent political pressures operating against Congress and the Executive force them in the direction of piecemeal solutions which don't cost much initially, but which, in the aggregate and over time, create the massive budget deficits now destabilizing the economy. Subjecting the Fed to the same day-to-day political pressures would lead to a similar destabilizing of monetary policy, and would thus create an awesome engine of inflation via the central-bank printing press.

Look around the world and you can easily pick out the countries with the best anti-inflation records. They are the ones whose central banks maintain an independent stance within the governmental framework. Among the major industrial countries, Germany and the United States alone fill the bill. In contrast, Great Britain's central bank was taken over by the Government several decades ago, and now that country is experiencing a chronic case of double-digit inflation, which not only has destabilized the economy but has also undermined London's long-standing position as a world financial center. Then again, in some Latin American and other countries, where the monetary authority has never exerted an independent stance, triple-digit inflation holds sway, bringing economic and political chaos in its wake.

Concluding Remarks
I'd like to conclude on a bicentennial note. In today's terms, the United States was strictly a Third World undeveloped type of economy when it gained its independence. But over time, we have combined a large

and willing labor force with vast infusions of capital and creative technology, within the framework of a far-flung transportation and marketing network and an enterprising financial system. As a result, we have achieved our present $1.7-trillion economy and the highest standard of living ever recorded. Surely we Americans have done something right over the past two centuries to create this achievement.

One of the things we've done right is to learn from experience, and to maintain the strength of those institutions that contribute to a strong and growing economy. We've learned how to guard against the ravages of recession, and we've recently begun to make progress too against the ravages of inflation—but I would argue that an independent central bank is the centerpiece in the fight against both of those evils. Our operating techniques change over time; for example, Chairman Burns now makes a formal report to Congress every quarter on the future direction of monetary policy. That approach is effective because it provides ample scope for the exercise of Congressional oversight, yet keeps day-to-day political pressures away from the details of Federal Reserve policy. I would say, let's give our support to this and the other institutions that keep America strong, and our tricentennial report will be even better.