



UNEMPLOYMENT AND INFLATION

Address by

**LAWRENCE K. ROOS
PRESIDENT
FEDERAL RESERVE BANK OF ST. LOUIS**

DOWNTOWN ROTARY CLUB

**JANUARY 6, 1977
BEL AIR HILTON
ST. LOUIS, MISSOURI**

Just as Christmas is "the season to be jolly," January is the season for making economic forecasts. With this in mind, your program chairman asked me to look into the future, both the immediate future and the period farther down the line, in an effort to forecast what lies ahead for the economy of our Nation.

Now, forecasting in any manner is always a risky proposition. Economic forecasting is especially tenuous because it involves not only making judgments about the effects of factors that can be relied upon with some certainty, but also depends upon many unpredictable factors such as future fiscal and monetary policy decisions, changing consumer attitudes, psychological vicissitudes of the business community, the whims of OPEC oil ministers and other factors which are impossible to anticipate.

But I'll try and, in doing so, will first discuss what we think to be the likely trend of the economy in the months immediately ahead, and then follow with some observations on the longer-term economic future.

First, what are the prospects for the new year? For 1977 we see a high probability of further moderate growth in the economy and modest success in reducing the rate of inflation. The recent decline in growth of gross national product was, in our judgment, essentially a technical adjustment in the recovery from the recent recession and to date, at least, is not indicative of basic weakness in the economy. Most economic indicators point to a resumption of the recovery.

An important determinant of short-term economic activity is the pattern of monetary expansion relative to the trend in growth of the money supply. Recently the rate of money growth has been above the trend rate that was established over the past five years, and this should contribute to a continuation of moderate expansion of real output on the order of perhaps 6 percent throughout 1977, with the rate of inflation running about 5 percent over the year.

There are additional positive factors for the short-term future. The rate of housing starts which reached 1.8 million units last year, in itself a high for the post-war era, may be exceeded in 1977. Capital investment by business is expected to expand, but certainly not in a booming fashion. The expectation of fiscal stimulus by the incoming national administration should have a positive effect on consumer spending. The recent decline in

interest rates should bring a quick end to inventory adjustments and encourage the expansion of inventories. Retail sales, which were fairly strong during the last quarter of 1976, should continue to be firm. The liquidity of banks, businesses and individuals is greater than it has been for several years. On balance, these and other factors should sustain the economy during the period immediately ahead.

Looking farther into the future is more difficult because there are so many factors that are simply impossible to anticipate. Even the clearest crystal ball cannot predict unforeseen political, social and economic shocks which inevitably upset the best made plans of mice and men.

There is one factor, however, which we do know is certain to have a profound effect on the long term economic future. That factor is the inflation that has been built into the economic system over the past ten years. Here we have not only an economic threat, but a threat to the very survival of our free society as we know it.

As President of a Federal Reserve Bank, I have a special interest in inflation because we, in the Federal Reserve, determine the fundamental rate of inflation through the monetary decisions we make. When the Federal Reserve's Open Market Committee decides that more money should be pumped into the economy, such action can have a very real long-term inflationary impact. Conversely, when the Fed decides to siphon money from the economy, it can decrease the money supply and thereby reduce the prospect of long-term inflation.

Now, monetary decisions by the Fed are not made in a vacuum. There are influences of fiscal, social and political nature which in a practical sense have a real bearing on monetary policy and thereby also have an impact on inflation.

One such issue is the rate of unemployment. I'd like to discuss the relationship of unemployment to inflation, as this is an issue which is receiving a lot of attention these days and which, if handled incorrectly, could have serious detrimental economic consequences. Today the rate of unemployment is 8.1 percent. There is no question that this level of unemployment is unacceptably high, that it places a severe burden on important segments of the population, notably unskilled workers in minority and teenage groups, and that corrective action is called for. The challenge is to act in a manner which will not

result in more inflation, because that in the long-run would aggravate the very problem we are trying to alleviate.

In this connection, it is important to recognize that unemployment and inflation are not alternatives to be traded off by economic policymakers. It is not a question of having to choose one or the other. Unemployment can be reduced without causing inflation. Prudent anti-inflationary policy does not mean increased unemployment. The traditional tools of monetary and fiscal policy can be used to fight inflation without generating increases in unemployment.

In order to intelligently deal with the current unemployment problem that faces us today, it is important that we have a clear understanding of the dimension of the problem. Who are the unemployed and why are they unable to find the jobs they want? What kind of government action is called for? Must we resort to public works programs, tax cuts and other stimulative and potentially inflation-causing actions, or are there other ways of meeting the problem which would not have the ultimate effect of leading to further inflation?

First, who are these 8 million people and why are they not able to find the jobs they want? As of November of last year approximately 50 percent of the unemployed had involuntarily lost their jobs. Eleven percent, or 862,000 people, had quit their last job. Thirty-nine percent were new workers or individuals reentering the labor market.

If we examine these figures from a different viewpoint, analyzing the number of people who are employed, we see that 56 percent of all people over the age of 15 presently hold jobs. This, by historical standards, is a high figure.

We might ask, if employment is near a historical high, why is unemployment also so high? The simple answer is people are entering the labor market at a sharply increased pace, far in excess of the economy's capacity to absorb them. A look at the past year gives some indication of the magnitude of the influx of workers into the labor market. From November 1975 to November 1976 total civilian employment increased by three million, a 3.5 percent increase. Concurrently, the number of people seeking jobs grew by the same amount, which means that the growth of new job opportunities, while rapid by historical standards, was only enough to absorb new workers and not enough to cut into the unemployment that already existed.

It is appropriate, then, to ask why the proportion of the population seeking work is increasing at such a rapid pace. One reason is the changing life-style of the American family. It has become more socially acceptable for wives to work. More teenagers find the work experience an important part of their search for broader and earlier independence from parental influence.

Perhaps an even more impressive causative factor is inflation itself. The rise in the rate of inflation since the mid-1960's, part of which resulted from efforts in the past to stimulate employment, has had the effect of unexpectedly increasing the cost of living and thereby stimulating second members of families to seek jobs in order to supplement the income of the principal breadwinner of the family. Many people found over the past decade that their expectations of real income growth were unrealistically high and in an effort to improve their ability to consume goods and services, they have sought second jobs or encouraged other members of their families to seek work.

It is ironic that the inflationary policies of the past ten years, some of which were designed to decrease unemployment, have actually increased the rate of unemployment. Inflation has created more job seekers than jobs.

But this is past history and is certainly no excuse for doing nothing. There are positive steps we can take to reduce unemployment without causing further inflation.

The most constructive action we can take, as I see it, is to give the unemployed marketable skills, the incentive to seek work, the ability to take advantage of their own best opportunities, to provide a favorable environment for much needed capital investment by business, and at the same time, to eliminate impediments to employment such as wage controls, job quotas and other structural bottlenecks.

Various governmental agencies are attempting to provide training for the unskilled and this effort does have some merit. But the government could do an added service by concentrating its efforts of providing better information on local, industrial and sectorial employment opportunities. Unemployment problems are distributed unevenly across population and the economy, and it would help a great deal for available workers to know where the available jobs are. This would not, in itself, insure more employment, but would remove most of the arbitrary nature of involuntary long term unemployment.

People who know of employment opportunities and choose to refuse them must be judged differently from those hard-pressed individuals who have no viable options.

Also, we must recognize that the unemployed will receive job offers only if employers believe that the unskilled worker can be hired, paid, and trained and still produce a product which can be sold profitably. Current market regulations, such as the minimum wage, magnify the problem of unemployment. Setting a legal floor under wages, without reference to levels of skill and training costs, causes the unskilled to bear the brunt of long-term unemployment. The minimum wage often precludes the unskilled from jobs which carry meaningful training opportunities and relegates these people to menial, dead-end jobs where they are vulnerable to each little variation in the pace of economic activity.

Other wage restrictions have similar effects. The Davis-Bacon Act, for example, sets wages on government-financed construction projects at no less than the prevailing wage in an area. Like the minimum wage, this provides a boon for the employed, and works to the disadvantage of the unemployed, since contractors naturally prefer to hire the highly skilled if they have to pay high wages.

It is time that we examine whether our various unemployment compensation programs are accomplishing what they were set up to do in the 1930's. Unemployment insurance was originally intended to help people through short periods of unexpected unemployment--12 to 16 weeks. This program has now grown to where benefits are paid, in some instances, for 65 weeks. These benefits are tax-free and amount, on average, to 60-70 percent of a comparable worker's income. Unemployment insurance, whatever its benefits, tends to encourage the unemployed to extend their unemployment.

Without action to eliminate these artificial impediments that interfere with the normal operation of the economy, the economy is doomed to prolonged periods of relatively high unemployment and the pressure for inflationary actions will grow. Much of the unemployment we have today results directly from well-intentioned interference in the labor markets, actions, which in themselves, tend to make people unemployable.

I have intentionally skirted the issue of the role that the Federal Reserve has to play in fighting the unemployment problem. As I said, the problem is largely structural

and thus beyond the direct influence of monetary actions. We can help, however, in an indirect but very important way. Our fundamental task is to provide a noninflationary economy. This would bring the unemployment problem into focus and reveal its basic structural elements. Inflation has proven to be like a plague, aggravating the stress within the economy, masking structural problems in some cases and actually making them worse in others.

A steady, noninflationary pace of economic activity offers workers and business people their best opportunity to plan for themselves and their futures without constantly having to protect themselves from unpredictable inflation.

This goal can be achieved by prudent monetary policy, a willingness to recognize and do something about structural impediments to employment and constant vigilance against the dangers of inflation. This, as I see it, is our economic challenge for the future.

* * *