Remarks by

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at the

National Press Club

Washington, D. C.

June 7, 1978

Thank you very much, Frank. You've certainly pegged me well; I did scribble this speech on the back of something like an envelope. But the Gettysburg address it's not! You've also discovered something about the power of the press and the power of the Chairman of the Federal Reserve. Obviously, you've been able to overcome the obstacle of the Federal Reserve's obscurity and to find out all of its hidden secrets. But I haven't been able to get the Governors to stop smoking. That's because they're appointed by the President for these 14-year terms -- we've got to do something about that!

I apologize to the press because you've been hearing me quite a bit during the last three months. When I first arrived in Washington -- I had just arrived, in fact -- a few members of the press got together and impressed upon me how irresponsible I had been because I had decided in advance to maintain an obscure and hidden position. They wanted to tell me that my decision was wrong. So after five press conferences in four weeks the press deserves it when they have to hear the same thing over and over again.

But this time it's different, because right after this session there's going to be a quiz for the press. So pay attention and be sure to get things right.

I do want to say, to Frank and to Joe and to others who are here, that it is a special pleasure for me to address the National Press Club today. This is my first appearance. I'm surprised to be here just as you're surprised to have me here because I never expected to be a banker of any kind -- and I certainly never expected to be a central banker. It's true that The Wall Street Journal, as Frank indicated, headlined my appointment with "William, Who?" But it's also true that my secret ambition at the end of my four-year term as Chairman is to find that headline repeated in all of your publications, "William, Who?" If, at that time, no one knows or cares who is Chairman of the Federal Reserve, then America will be enjoying an unparalled period of prosperity, without inflation and with a strong dollar. I will be forgotten, but the world will be better off.

In the meantime, conditions are otherwise. The past dozen years have been characterized by dramatic shocks and discontinuities. The war in Viet Nam was divisive. The state of domestic tranquility was interrupted by civil disorders. Failure to pay for that war planted the seeds of inflation. The threat of inflation led to imposition of direct wage and price controls which proved to be both inequitable and ineffective. The international monetary system broke down. With controls holding down the lid, the U.S. economy was reflated building up a head of steam in the kettle. When the wage and price controls were removed, the steam blew off as double digit inflation and double digit inflation rates. To compound the difficulties, the oil boycott ushered in a five-fold increase in world petroleum prices. The Watergate incident and its aftermath led to a general distrust of all institutions, public and private. Finally, there was the great recession of 1975, with nine per cent unemployment and the greatest economic distress since the depression of the 1930's.

Now we are in the fourth year of economic recovery from those troubled times. The level of prosperity has advanced considerably. Social and political conditions have become more stable. Yet, in the face of progress there remains nagging uncertainty.

This is not because of any lack of agreement on economic goals. There is universal accord that our objectives should be full employment, price stability, and a sound dollar. The uncertainty arises because many have come to question whether those goals can be achieved.

America's economic goals <u>can</u> be achieved. The means to do so are at our disposal. All we require is the will. All that is needed is the realization that there is a confluence of individual self-interests that compels us toward a common effort. Divided, we shall realize none of our goals. United, we shall accomplish all.

Inflation is now our most serious domestic problem. It is the number one issue, not because it has precedence over the quest for full employment, but because under present circumstances it is the primary obstacle to achieving full employment. Inflation is inextricably linked with unemployment. Our hopes for full employment on a continuing basis depend upon wiping out the virulent disease of inflation. Inflation destroys values and incomes, dries up job-creating investments, impairs the prospects for new housing and other construction, and breeds recessions.

Perhaps the best way to illustrate the clear and present danger of inflation is to consider the consequences for young people who are graduating this month from America's colleges and universities. If inflation should be permitted to continue at the present annual rate -- expected to be seven per cent or more this year -- then when today's college graduates reach normal retirement age, the dollar they now hold would be worth less than a dime. Let me emphasize that: at age 65, the dollar held by today's graduates would be worth less than ten cents.

We cannot let that happen to our young people, or to Americans of any age, or to the world. We simply must prevail.

The value of the dollar is related to inflation. The decline in the value of the dollar since last September has caused worldwide concern. The reason for the slide can be traced to the record U.S. trade and current account deficits and to the level and persistence of U.S. inflation rates. The decline in the dollar itself adds to inflationary pressures as the goods we import cost more and reduce competitive constraints on domestic products.

The United States has a special responsibility to maintain a sound and stable dollar. It is the currency for most international trade and finance. It is the principal reserve asset for the world's monetary system. The dollar is therefore the key to world economic progress. And in our own self-interest, we need a sound dollar to dampen inflationary pressures here at home.

As the world becomes more interdependent, the role of the dollar will be a continuing challenge. The bridging actions taken in recent months have helped stabilize the dollar, and it has regained some of its lost ground. More important -- most important perhaps -- a stable dollar over the long term depends upon the creation of a clear strategy to lower inflation and reduce our international deficits.

One important factor in all of these considerations is energy. America was fortunate to be able to develop as a nation by utilizing the seemingly boundless resources of a vast, almost unpopulated continent. The availability of abundant and inexpensive energy fueled the growth of a great industrial economy. But with six per cent of the world's population consuming 30 per cent of its energy, it was inevitable that a day of reckoning would come. The forces of supply and demand came into play with a vengeance. In 1973 the United States imported $8 billion in oil products. Last year it was $45 billion. This contributed to the large U.S. trade deficit and to the pressure on the dollar.

The task ahead is to convert our industrial, commercial, residential, transportation and public infrastructures into more energy efficient systems. We need to conserve present energy reserves, to reduce dependence on foreign petroleum, and to change over to alternate, more economic energy sources. This process will certainly take more than a decade or longer.

It is clear that our economic problems are interrelated. Inflation contributes to the decline of the dollar; the decline of the dollar contributes to inflation. Inflation drives up interest rates and breeds recessions which cause unemployment; unemployment causes large Federal deficits which contribute to inflation. Our task is to break the vicious circle. In endeavoring to do so, we can learn from history, but the lessons of the immediate past are not encouraging. Perhaps it is time for us to take New Directions to help shape a stronger America and a better world.

One such New Direction would involve a conscious shift in the philosophy of U.S. economic policy from "demand" or "consumption" management to "supply" or "investment" management.

Let me cite two periods when leading world powers have been subjected to hyper-inflation. The first occurred in 16th century Spain. The discovery of the new world gave Spain access to vast amounts of gold and silver. Gold from the new world introduced massive unearned purchasing power into Spain which drove prices up perhaps a thousand per cent. That purchasing power did build great palaces and it did provide the most elegant life style that had ever been experienced up to that time in Europe. However, the resources were used for consumption, with little attention to investments for the future. So, by the 17th century Spain had run through its wealth and was economically barefoot.

Is there a parallel in our 20th century experience? Through the printing presses there has been a massive creation of unearned money and credit. The United States has built the most affluent nation ever known, with the highest standard of living for the greatest number of people. Is this but another example of overindulgence in consumption? Will we neglect investment and deplete our capacity to provide for future generations? Will the legacy of our time be an economic desert?

A second New Direction would be to shift resources from the public sector to the private sector. The present percentage of GNP represented by expenditures of Federal, State, and local governments has grown steadily, until it may have reached the point of being counterproductive. During the last decade it has become apparent that government spending does not always produce the expected results -- economically or socially -- and that it may not be the most effective way of reaching our desired objectives.

Amidst growing disenchantment, a more promising course would be to return more of the spending decisions to individuals and to businesses where the cumulative effect of thousands and millions of private initiatives would be more efficient in sustaining and expanding economic progress.

The New Directions for economic policy should include specific strategies and quantitative targets that give a clear picture of where we want to be going. With such a blueprint, it would be possible to evaluate all proposed policies and actions as to their contribution toward achieving the established goals.

Perhaps this could best be accomplished by designing a model economy that would represent the ideal condition sought within a reasonable time -- perhaps five, six, or seven years. Then our economic policies could be directed on a steady course to reach those targets we decided upon in our model. The components of such a model might include the following:

First, we should seek a balanced budget with full employment. With the steps already taken or planned, the budget deficit for FY 1979 is now expected to be $50 billion or less, down from the original $60 billion estimate. This trend should be continued, with reduction to less than $40 billion in FY 1980; to less than $20 billion in FY 1981; and reaching a balanced budget in FY 1982.

Second, the percentage of GNP represented by Federal expenditures should be reduced gradually over the five-to-seven year period from 22 per cent of GNP to 20 per cent. Even though the Federal Government would still be spending more than it is now, such a program would result in $50 to $75 billion less in spending than otherwise would be the case. And these resources could be shifted back to the private sector.

Third, we should establish a policy that will achieve a substantial increase in business fixed investment. The United States has been neglecting its capital base, underemphasizing the issue of investment for the future, just as Spain did in the 16th century. We are falling behind other principal nations. Japan spends 15 per cent of its GNP for capital investment; Germany, 21 per cent; the United States, 8 or 9 per cent. Over the decades we've been falling behind in our productive capacity, our efficiency, our productivity, and our technology.

One technique for stimulating more capital investment could be a substantial liberalization of depreciation allowances so that the cash flows from risky investments would justify the investments. Later, we could explore the possibility of stimulating other avenues of capital formation -- private investment and entrepreneurship. But overall, our goal should be -- for the five-or-seven year period in our model -- to increase capital spending from 9 per cent to 12 per cent of GNP.

Fourth, we should have a policy as to housing, which has also fallen behind our demands in many periods. In the next five years it would be appropriate to see housing increased by 75,000 or 100,000 units per year -- each year -- until we reach levels that are consistent with our national needs.

Fifth, we should have a vigorous program of exports, with the specific goal of increasing our exports of goods from about seven per cent of GNP to ten per cent. This would go very far toward correcting the balance of payments deficit which plagues us and which threatens the value of the dollar, and would provide more absorptive capacity for trade with other nations.

Sixth, as our program progresses, building up the capacity to shift resources to the private sector, we should plan for additional tax reductions for individuals. This goal must not conflict with the goal of balancing the budget. It is consistent with the goal of reducing government expenditures and giving more of the spending decisions back to people.

Seventh, we should be more attentive than we have yet been to regulatory reform, in order to remove the inflationary impact of government actions outside the monetary and fiscal spheres.

And eighth, we should establish a definite commitment to reducing inflation on a steady basis, at the rate of 1/2 to 3/4 per cent per year, until we reach our goal of price stability, full employment, and a sound dollar.

These are eight points or New Directions in a strategy that could enable us to overcome -- in a reasonable period, an attainable period -- all of those terrible diseases which now threaten our vitality.

I must say to you that since I have been in Washington most of my attention has been directed to the short-term problem -- the dilemma we face at the Federal Reserve in trying to resist inflation in the short term and the necessity we face of finding a coordinated fiscal and monetary policy that ensures that the Federal Reserve is not left to do the job alone. A great deal of progress has been made in that regard. It is extremely encouraging to see the change of attitudes in Washington and to see the specific, concrete steps that have been taken along these lines.

But we still face a very trying period. In the next few quarters we will face the test of endeavoring to restrain inflationary pressures enough to avoid the dislocations that otherwise will result, while not slowing our economy into a recession. And this will require the best skills that we can marshall from all those who participate in or are involved in Government and from all those who have management or financial responsibility in the private sector. Beyond this trying period, the opportunity exists for our longer-range strategies to be brought into play.

My message today is: inflation is a terrible problem. We must conquer it. In the short term, we have the very difficult task of treading our way through a narrow passage. In the longer run, with a united nation, we have great prospects of achieving our goal. And if we do, economic stability, full employment, a sound dollar will not only contribute to our own well-being, but will yield the only sure way to peace and prosperity throughout the world. Thank you.

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