

REMARKS OF
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When I came to Washington eight months ago, it wasn't yet perceived that the biggest problem, the most important domestic problem was inflation. Since that time, inflation has really escalated in everyone's concerns.

We live in changing times, and there are many reasons why we have been brought to the point where inflation is a critical problem. It relates not only to our well-being, but also to our interrelation with other countries of the world more than we can imagine.

In your industry, you have been aware of the great technological changes since World War II that have transformed industrial activities, and of their implications. You have probably also been conscious of the great social changes. Our society is now made up of more young people -- because of the wave of births following World War II -- and of more older people -- because of longevity increases -- and so there are relatively fewer people producing the goods and services we all need. You are aware of the kinds of changes this entails.

You've also been aware -- consciously or unconsciously -- of our shift from a rural, agrarian society to an urban society. Certainly, at the turn of the century, most Americans still lived on farms and in families of three generations which ordered and transmitted experience; now, most Americans live in urban areas with only one, one and a half, or two generations in a household. The peer group for finding out what life is about and how to deal with it is completely different.

We've also seen tremendous change in the political climate, accompanying the birth of literally a hundred new nations, and the breakdown of international systems that governed prior to World War II. This has accelerated, causing all kinds of tensions.

As all these things happen, it is not surprising that we've lost some of our markers, lost our bearings a bit, and gone through a period of groping. It is my hope that we are coming back to a time when we can approach more logically and with more objectivity the kind of issues we must deal with if we are to restore the economic vitality we need for our own well-being and for world conditions that are conducive to peace and prosperity.

In the short time I have been in Washington, inflation has been recognized and has become the number one domestic problem. Inflation grew up over a period of time because our aspirations had run somewhat beyond our capacity to create all the things we wanted or thought we were entitled to. We are paying a price now for twelve years during which we did not save, invest or create the productivity to achieve the level of economic output and economic abundance that we all wanted.

In that atmosphere, it was my duty on March 9, the first day I was in office, to point out this severe problem in testifying before the House Banking Committee. Since that time, monetary policy has moved high on the list of interests because it is one of the key factors for dealing with these conditions.

Monetary policy faced a very serious dilemma when I came to Washington. In the face of accelerating inflation, and without other policy responses, monetary policy was faced with a very difficult choice. We could respond immediately and try to handle the situation by ourselves by restraining money and credit -- in which case we would have brought the economy to its knees -- or we could validate inflation by continuing to make credit and money abundantly available -- in which case we would have put off the day of reckoning, but eventually been called to account for conditions far more harsh and far more destructive to our society.

We chose a slightly different course of blowing the whistle on inflation, of trying to attract attention to the problem and to sell the proposition that the problem required response from all those who deal with the economy -- particularly those in the government, but also those in the private sector.

Since that time, we have slowly been in the process of declaring war on inflation, of mobilizing the arsenal of weapons that is essential if we are to destroy this enemy and return to stability.

Let me just comment for a few minutes on that arsenal of weapons and how it's been growing. Then with the time we have left, I'd be delighted to respond to any of your questions or give you equal time to rebut what I am going to say.

The arsenal of weapons includes, first, fiscal policy; second, incomes policy; third, reduction of regulatory burdens; fourth, revitalization of productivity; fifth, balance of international accounts; and sixth, a responsible monetary policy.

When I took office in March, the outlook for fiscal policy in FY 79 was for a federal budget deficit of \$60.5 billion, an increasing deficit. This as we completed the fourth year of economic expansion and during the year that we would enter the fifth year of economic expansion from the great recession of 74-75. We also faced a policy of taxation which would contribute to that deficit by giving a large dividend to the American public in an election year.

It was also expected that the economy would grow at a real rate of 4-3/4 per cent, a very high rate of growth considering the 5.5 per cent real growth in 1977 and the 4.6 per cent real growth in 1976 that had already built up a high utilization of economic capacity.

Fiscal policy has changed, and while none of us can be satisfied that it has done all the things we would dream of and hope for, we should give good credit to the Administration and to the Congress for their willingness to shift these policies so quickly. It is unprecedented. I know of no time in American history when fiscal plans were shifted so quickly in response to a perceived danger.

As a consequence as we entered FY 79 on October 1, that expected deficit of \$60.5 billion had been reduced to \$38.5 billion, a \$22 billion reduction in planned fiscal stimulus. The rate of growth for this calendar year had been reduced from a 4-3/4 per cent target to 3-3/4 per cent, evidencing, in the face of an election year, a willingness to bring the economy to a slower rate of growth, to cut the amount of tax reduction, to cut the amount of spending -- and to make some changes.

Many of you may say; 'well, more should have been done!' My only point is that something was done and it was of an order of magnitude that was more than insignificant.

Second, as to incomes policies, the President gave the first indications of an incomes policy on April 11, when he took up the theme of inflation as a serious and present threat. At that time, he asked for moderation, but as the year progressed and as it was apparent that inflation was more virulent and the problems more pervasive, he accelerated his policy responses. On October 24, he introduced the concept which you all are now struggling with: a voluntary program of wage and price restraints with some standards for wages and prices.

I'm delighted, personally, that the President has not opted for and will not opt for mandatory wage and price controls. Mandatory controls are inequitable, inefficient, won't work, and shouldn't be tried. But I do think there is something to be said for a policy of standards. If we had a speed limit in America today that was described to you simply as "drive at a reasonable speed," then with well-engineered automobiles on well-engineered tires everyone would be driving about 80 miles an hour. We have a speed limit of 55 miles per hour; I'm not sure you drive at 55, but I'm sure you drive nearer to 55 than to 80.

When it comes to the economy, if we set up some "speed limits" on wages and prices, I don't know what the outcome will be because these are voluntary, but I do know we'll get behavior closer to those standards than if we had no standard at all. In that sense, we all can gain something by an

incomes policy as a companion to these other fundamental policies in the fiscal and monetary areas.

I also know that the success in this particular area of restraint depends entirely upon the degree to which the private sector, management and labor, is willing to cooperate and willing to see and understand that its own self interest is tied to the process of curing this dreadful disease of inflation.

I rather suspect that in your industry you will cooperate because you have a history of responsible cooperation with government in areas where we have a common interest and a common objective, and I'm counting -- and I'm sure the Administration is counting -- on that kind of support.

A third important weapon in the arsenal is the reduction of regulatory burden. We have had high aspirations for improving our environment, improving the conditions in which we live and we work, and these are certainly desirable objectives. What we have failed to do, occasionally, is to implement our improvements through regulations and procedures that are appropriate, in terms of their cost or their management burdens to the benefits we receive.

I'm not going to dwell on this subject. I hope we don't lose sight of its importance. I hope that, whatever happens with inflation, there will continue to be a vigorous effort in this field, because the payoff comes slowly and without drama. There will be a tendency, if things do get better, to forget this area, but I hope that you will be among those who continue to clamor for responsible regulation that will reduce the burden, and yield us the benefits we want with appropriate costs.

The Federal Reserve doesn't lay a heavy burden on society through its regulation, although it lays some burden on banks and financial institutions. But while that burden is not, in the aggregate, large, we intend to examine and rewrite every regulation we have on the books in the next year in order for us to make a contribution -- even in a small way -- to bringing better sense into the whole regulatory area.

A fourth important weapon in the arsenal is to revitalize productivity. Productivity has been the key during much of the post-war era to the rising real incomes of businesses and families. We've lost our way in this area. For the first twenty years after World War II, productivity gains ran at an average of 3-1/3 per cent a year. They contributed to conditions under which we could achieve real income gains. For the last ten years, productivity gains have only been 2 per cent -- which is terrible -- but for the last five, the situation has been worse: productivity gains of only 1-1/3 per cent. There is no way we can maintain our competitiveness in the world or break the cycle of wages chasing prices and prices chasing wages unless we find, again, the key to productivity gains. These would allow us to accomplish our tasks and give us the resources to increase our own yield from the economic system.

On this same point, we have neglected the investment side of our economy. We have managed our economy for too long on the demand side, and we have not given adequate attention to supply. We have underinvested. Germany spends 15 per cent of GNP for business-fixed investment; Japan, 20 per cent; the United States, 8 or 9 per cent. It's no wonder that we are falling behind.

There is just no question that in the government and in the private sector and through your associations we need to generate understanding about this issue and bring about conditions that will incentivize the commitment, the assuming of risk that goes with business investment, so that we can step up our level of investment to 12 or 13 per cent of GNP over a period of 10 or more years, so that we can reestablish our industrial leadership, so that we can re-engineer the costs that go into our system. Then, we can have a modern, efficient, productive capacity, reduce our energy costs per unit of output, renew our technology, and once again achieve leadership in the world.

A fifth important weapon is to reestablish balance in our international accounts. We have suffered for some time from the good fortune of having inherited a continent of abundance. Because we had a continent that was sparsely populated, with abundant and inexpensive energy, we have used energy in lieu of other resources to build our standards of living. Our population is 6 per cent of the world population, but we use 30 per cent of the world's energy.

That was all right when we had abundant, inexpensive energy and a small population. But as our desires for energy continued to increase geometrically, and we used it wastefully because it was so inexpensive, the day of reckoning was finally to come. We now have ahead of us the prospect of requiring ten or fifteen years to convert our industrial stock, our transportation stock, our residential stock to energy efficiency, and to increase and

develop the utilization of our indigenous sources of energy. These are the alternatives to what we have accepted as a short-term necessity; that is, the importation of large amounts of expensive petroleum.

In 1973 this nation imported \$8.5 billion worth of oil and oil products; in 1978, this year, it will be over \$40 billion. In 1973, this country had a balanced trade account. This year, we will have a deficit of \$32 billion.

It is that kind of deficit, along with our high inflation rate, that contributes to a weak dollar. Once a currency becomes weak, it adds to inflation, because the things we import cost more and also take competitive pressures off domestic products. The decline of the dollar in the last year has added one per cent to our inflation rate, constituting a tax of \$20 billion on all Americans. The more a weak dollar contributes to inflation, the more the dollar weakens and the more vicious the cycle. On the other side, the more a currency like the yen appreciates, the more cheaply it can buy its imports, the less inflation it has, the stronger its currency, the more it can buy cheaply. We've got to break this cycle of the dollar.

We are beginning to do so. The process is underway. But one of the keys was to buy the time that is essential to solving the fundamentals of reducing inflation and balancing our accounts. For that reason, on November 1, we announced the actions that you know about, combining the strong medicine of monetary restraint with very forceful bridging actions to correct the disorderly foreign exchange markets, to restore stability, and to enhance the

prospects for continued moderate growth of our economy as we wring out inflation.

Finally, there is the sixth weapon of monetary policy. Here, we are trying to accomplish a minor miracle by implementing and supporting the other economic and anti-inflation policies in a way that will give us a new approach to wringing out inflation. We are attempting consciously to slow the rate of growth of the economy, to do so on an orderly and steady basis, without jolts and upsets, without dislocations. We are attempting to do so while maintaining balance in the economy, avoiding the burden of restraint falling too heavily on one sector. For that reason, we authorized the new money market certificates that have allowed resources to continue to flow into thrift institutions and support housing, and allowed the housing industry to continue at a decent rate of production when prior experience would have predicted disintermediation and decline.

So we are seeking a slowing in the rate of growth, a steadiness in the slowing, a balance in the condition of the economy, so that we can maintain a reduced rate of growth without a recession and avoid creating a political environment of reflation as happened in 1974-75.

Monetary policy is poised to be forceful, steady and determined. It is indeed reassuring to find that for the first time I can remember in quite a while monetary policy, as tough as it is, is being applauded by the private sector, being applauded by the Congress, and being applauded by the President. That's a new day, and it gives me courage and hope.

Let me assure you that monetary policy will -- as the President suggested in his October 24 speech -- continue to be responsible and do its part in seeing that we win this war against inflation so as to bring about conditions for price stability, full employment, and a stable dollar that are essential to our well being.

I know that all of you here would share the general view that all these problems are fundamentally the result of government, that government is the culprit. Of course that's true; government has been a very large contributor to our problems, and there is no reason the government should duck its responsibility. Certainly, at the Federal Reserve, we don't intend to duck ours.

But let me remind you that we live in a democracy, and we live in a world, fortunately, where the private sector has far more influence than it realizes on its government. For that reason, I think you have far more capacity than you realize to contribute to strengthening this arsenal of weapons and making sure we succeed in this war.

I'm reminded of a paraphrase from the comic strip Pogo, where Pogo says, "I have met the government and he is us." To the extent that you want your government to correct its imperfections of the past, it needs your voice, your support, your understanding, your encouragement. I'm sure that if we have that, the government itself will reform and will play its role.

We at the Federal Reserve will certainly play our role.