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Remarks by

G. William Miller

Chairman

Board of Governors of the Federal Reserve System

at

Commencement Exercises

Babson College

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Thank you very much President Sorenson, members of the Board, faculty of Babson, and members of the class of 1979, undergraduate and graduate.

It is a particular privilege and responsibility for me to share a few moments with you here this morning. It is a privilege to celebrate your accomplishments and a great responsibility not to stand too long between this moment and the time you say your farewells to faculty and friends and get about the work of the world. I'm particularly delighted to be at a place where everyone knows what the Federal Reserve is. When I speak with most graduating classes they still think the Federal Reserve is an Indian reservation. I'm glad to be with those of you who know about M1 and M1 plus and Federal Funds and repurchase agreements and Euro-currencies, which all of you do.

But it is also a privilege to be at a place that has honored, with its academy of distinguished entrepreneurs, the great business leadership which is the strength of this Nation. I recall the first entrepreneur that I met was a classmate of mine who was both a ne're-do-well and not very bright. After only two years, when we came to a class reunion, he was the only one who had his own chauffeur-driven limousine. It surprised us, and we were naturally curious as to how he had become so affluent so quickly. But being a man of finance, he explained it to us. He reported that he had gone into business for

himself. He had taken up making widgets. They cost \$1. He sold them for \$5. And he noted, that 4 percent adds up!

But, of course, the greatest entrepreneur I've ever known is a man you've already honored -- Royal Little -- who perhaps taught me more about business than even the great faculties who taught me in my college and university years. So for many reasons I'm pleased to be here. And I would like to make a couple of points that I hope will be of interest to you.

Next October we will be commemorating the 50th anniversary of "Black Friday," the great crash on Wall Street. I understand that Roger Babson predicted that crash. I understand that he predicted it for five years. But it is noteworthy that it will soon be 50 years during which this Nation has not suffered a major economic dislocation, market disruption, serious money crunch or economic panic. That is impressive evidence of the sound structure of our financial monetary system and of how well it has served us. Yet, that crash was a very important event which helped shape economic policies for a whole generation. The policy responses were directed toward effecting reflation. New techniques were developed to use government spending as a means for economic stimulus. Floors were built under wages and prices to prop them up so as to prime the pump and get the economy going. Young people who grew up in that time, during the 1930's, learned powerful lessons from their bitter experiences. It is interesting, I think, as you graduate today, to contrast the circumstances that have attained during the prelude to your personal careers with the conditions of those times.

The past dozen years have been just as dramatic in the development of our Nation and our economy. Those dozen years have been characterized by powerful shocks and discontinuities. The war in Vietnam was divisive. The state of domestic tranquility was interrupted by civil disorders. Failure to pay for the war planted the seeds of inflation. The threat of inflation led to the imposition of direct wage and price controls, which proved to be both inequitable and ineffective. The international monetary system broke down. The U.S. economy was reflatated, building up a head of steam in the kettle. When the discredited wage and price controls were removed, the steam blew off and we had double digit inflation and double digit interest rates. To compound these 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. And finally there was a great recession of 1975 with 9 percent unemployment and the greatest economic distress since the Great Depression of the 30's. And so your young years have been filled with far-reaching changes and stresses within our system.

During those years there also have been powerful lessons to learn. We have learned some of the limits of government. We have learned to appreciate the fundamental values that exist in our private enterprise system. It has been demonstrated that government spending alone cannot fulfill our aspirations, that excessive regulation can stifle the initiative of creativity which is essential to achieve economic well-being and social justice.

The legacy for you, from our own experience as a Nation and from the accelerating pace of change throughout the world, is an agenda of unresolved issues. The agenda you will face is formidable indeed. I will not try to list every item on that agenda; but let me reflect on a couple of items which will deserve high priority throughout your careers.

One is energy. America was fortunate to be able to develop through utilizing the seemingly boundless resources of a vast, almost unpopulated continent. Availability of abundant and inexpensive energy fueled the growth of a great industrial economy. But with 6 percent of the world's population consuming 1/3 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 paid \$8 billion for imported oil products. Last year we paid almost \$45 billion. This contributed to the large U.S. trade deficits and to downward pressure on the dollar. During the next quarter of a century, while your leadership will be critical to this Nation, we will have ended the era fueled by abundant and cheap petroleum. And we will need to make a major transition, of a magnitude seldom experienced in history, from an industrial system based upon this form of energy source to a new system based on new sources of energy and technology. The task ahead is to convert our industrial, commercial, residential, transportation and public infra-structures into more efficient energy systems. We urgently need to conserve present energy reserves, to reduce our dependence on foreign petroleum -- and on petroleum as an energy

source itself -- and to change over to alternate and more economic energy sources. This process will take much of the remaining years of this century.

A second item that will be on your agenda for a long time to come is inflation. Today, America's most serious problem is inflation. And inflation is inevitably linked with employment and unemployment. Our hopes for economic well-being for all Americans depend upon our wiping out this virulent disease. Inflation destroys values and incomes, drives out job-creating investments, impairs the prospects for new housing and other construction, and breeds recession. Perhaps the best way to illustrate the clear and present danger of inflation is to consider the consequences for your own lifetimes. If inflation should continue at the rate we are experiencing this year until you reach retirement age -- say age 65 -- then the dollar you have in your pocket today will be worth less than a nickel.

We just cannot let that happen to you, and we cannot let that happen to America, and we cannot let it happen to the world.

During the year I've been in Washington there have been some important shifts in policy to deal with this difficult problem. We know the fundamental causes of the problem have built up over a long period of time. We know that inflation is deeply imbedded; that it is structural as well as cyclical. And it will, therefore, take a long time to unwind the process by which we have built it into our system. Some fundamental, as well as some short-term policy directions, are being taken in response.

One of the most encouraging policy changes has to do with the role of government in our society. There has now been a conscious shift -- reflecting, I believe, the viewpoints of the American people -- away from dependence upon government spending and back to more reliance on the private sector.

In particular, a year ago at this time the plan was for a continuing increase in Federal deficits to try to provide for some of our economic needs. A decision was taken to reverse that trend, to reduce the deficits, and to reduce the relative role of Federal spending in our economy. We are now on a course that will bring us toward a balanced Federal budget by fiscal year 1981. We are now on a course of action that will reduce Federal expenditures from 23 percent of gross national product down to 20 percent or less. Over the next four or five years, as you progress in your careers, that will mean some \$60 or \$70 billion transferred from government to the private sector. The cumulative decisions of individuals and businesses for spending and investment of those funds will be far more effective in sustaining our economic well-being than the same monies spent through government.

A second important policy shift has had to do with our international accounts. A year ago the dollar was weak and under attack. The decline of the dollar from September, 1977, through October of last year added one percent to the inflation rate because of the higher prices paid for imported goods and because of the lessening of competitive foreign imports. Because of the ripple effect of resulting price changes proceeding through the system, we still will have one percent inflation

this year from the same cause -- even though the dollar is now stable. So over 1978 and 1979, American consumers will pay \$30 billion more for their purchases as a result of a weak dollar. It is for that reason that a new commitment to maintaining a fundamental economic policy, a sound and stable dollar, has become part of the government program. Last November 1, the Administration and the Federal Reserve, in cooperation with the governments of Germany, Switzerland and Japan, launched a powerful program to demonstrate forcefully that we would maintain a sound dollar and that we would maintain an orderly market for the dollar on foreign exchange markets. As a result, the dollar has strengthened. Already we are beginning to find the benefits of that strength, and there is once again a sense of confidence in the American system.

There are other complementary policies that have been put in place, such as the incomes policy to moderate wage and price increases in order to gain time until the more fundamental fiscal and monetary policies can take effect. We also have important energy programs beginning to evolve, but they still need to be completed. During this period there has also been, I think, a new appreciation for the proper role of monetary policy in the effort to achieve price stability. Monetary policy had been positioned toward restraint. It has been our purpose in implementing monetary policy consciously to slow down the growth rate of the U.S. economy, in order to avoid an overheating from excess demands that would unleash a new round of inflationary pressures. A second purpose has been to slow the economy on an orderly, progressive

basis, rather than through shocks and dislocations, so that adjustment to lower levels of activity can take place smoothly and that businesses and households can adapt themselves knowing the course of the economy.

A third objective has been to achieve the desired slowdown while maintaining balance within the economy, thus avoiding placing too much burden on any one sector. Fourth, it has been our purpose to accomplish all this without throwing the economy into a significant recession, which might tend to encourage new Federal spending programs which would set us off again on a period of higher deficits, excessive government participation in the economy, and a treadmill of inflation building upon inflation.

All these policies can have their effect only over time. It will take five, six or seven years to wring inflation out of our system. So the early years of your careers will be ones in which you will be challenged to look at the higher and better use of your resources to achieve your goals without contributing further to the tendency toward this inflation bias.

There will be a necessity in these years to adopt one further important new policy that is critical to our long-term well-being. That is, to shift our emphasis in economic management from consumption to investment. It is essential that we make that shift. An example of why can be taken from the experience of 16th century Spain. In the 16th century because of the discovery of the new world, Spain had available to it vast amounts of gold and silver. Unearned purchasing power was generated, not by saving and investment in productive capacity, but by the random event of discovering this gold and silver.

That purchasing power introduced into Europe created one of the most massive inflations in our recorded history. In Spain, prices were driven up 1,000 percent or more. The most elegant society ever seen in Europe until that time was built, with great palaces and with general well-being for everyone. But because it was built on a philosophy of consumption, once the resource had been used up and not replaced, there was little left to sustain the good time. In the 17th century, Spain was, economically speaking, barefoot.

In the 20th century we have discovered the unearned purchasing power of the printing press. We have sought to fulfill our appetites for consumption by continuing to issue money and credit. Unless we shift our philosophy toward putting more back into the system -- rebuilding the capacity to produce and achieving once again the rates of productivity gains that were typical during our highest period of achievement -- unless we do that, the heirs of our efforts may also be economically barefoot.

But I think you should go forth today with a great sense of confidence. America is a remarkable country with great resilience and great strength. It has an abundant harvest of bright, well-prepared young people here today who will provide the leadership, the knowledge, the skills, the determination, the will, to implement these new policies and to stick with them until they achieve our fundamental economic goals of full employment, price stability, and a sound dollar. And in achieving those goals, it is critical that you, as I know you will, become the source of strength that preserves and

enhances the unique characteristic of the American economy which distinguishes it from other countries -- that is, a basic system of private enterprise.

In that system of enterprise not only do we benefit from an inherent quality of efficiency that will contribute toward achieving our goals, but also we enjoy the blessing of free choice that is essential for a free society. If during your careers there should ever be a threat to that private enterprise system, then none of your personal freedoms would be secure.

I am sure you will be faithful stewards, and will achieve far more than those before you. Because of this, I am also confident that America will succeed, will overcome this period of difficulty, and that America will again clearly merit its position as the first nation in economic achievement, in social justice and in its contribution to peace and stability throughout the world.

Thank you very much.

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