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BEFORE THE MEETING OF THE U.S. - CHINA  
JOINT ECONOMIC COMMITTEE  
SEPTEMBER 16, 1980

It is a pleasure to be able to address you today about the U.S. economy. Our countries have a great deal to learn from each other, and I hope to be helpful in that process. My remarks will proceed in the following order. First, where does the U.S. economy stand at the present time? Second, what are the key elements of the economic revitalization program that was announced late last month by President Carter? Third, what is a realistic view of future prospects for the U.S. economy?

Current Economic Situation

The present U.S. economic situation is to a considerable extent a temporary result of the second "oil shock" resulting from the 1979 round of OPEC price increases. By early 1980 the world price of oil had nearly doubled from the level of a year earlier. The oil price shocks of 1973-74 and 1979-80 imposed difficult adjustments for the U.S. economy to make. The initial oil price shock in 1973-74 seriously worsened the U.S. inflation situation and was a major cause of the deep recession of 1974-75. Therefore, a sizable adjustment to last

years price increase had to be expected. However, this time the U.S. economy has shown a remarkable degree of resiliency. Our efforts over the past few years in the energy field are beginning to become more and more effective. Even so, the inflation situation worsened early this year as the much higher prices of imported crude oil worked their way through the U.S. cost-price structure.

As inflationary pressures intensified, interest rates moved sharply higher. Early in 1980 the economy seemed to be moving into a very inflationary phase and domestic financial markets were temporarily disrupted. The situation clearly called for corrective action.

President Carter announced a set of anti-inflationary measures at mid-March. The key elements were:

- o Increased fiscal discipline by the Federal government.
- o A credit restraint program by the Federal Reserve.

The program had a very dramatic and beneficial effect. Inflationary expectations were reduced and interest rates fell very sharply. For example, the 3-month Treasury bill rate temporarily fell below 7% in contrast to a peak earlier in the year near 16%. The prime rate -- the rate at which our private commercial banks lend to large corporate borrowers -- fell back to 11% from its peak of 20%.

While the inflationary fever was broken, the economy fell sharply for a few months, and a gradual rate of descent has been continuing. We correctly judged that the recession adjustment could be held to tolerable proportions without the need for massive countercyclical action. Such action could have made a difficult inflation situation even worse. Now a wide range of economic statistics suggests that the worst of the decline lies behind us and that the economy is poised for renewed expansion.

The exact timing of the upturn remains in question. The consensus of economic forecasters -- inside and outside government -- has been locating the initial quarter of positive real growth in the first quarter of next year. The situation now begins to look a little stronger. Given the margin for error of such forecasts, growth may well resume before the end of this year. The important point is that there is no longer the threat of a serious and prolonged recession. Instead, the economy soon will be moving on an upward path.

The inflation picture is mixed but not quite as encouraging as the general economic outlook. The consumer price index was unchanged in July but that was largely a temporary phenomenon associated with swings in mortgage interest rates.

Wholesale prices have been rising rapidly, partly because of the effect of severe weather conditions on food prices. Certainly, a serious inflation problem remains, but one which we are determined to bring under better control. We recognize that the long-run strength of the U.S. economy depends closely upon our ability to keep the dollar strong at home and abroad.

In this connection, we are encouraged by recent U.S. balance of payments developments and the near-term outlook. Last year the current account of our balance of payments was virtually in balance. In the early months of this year, our current account swung into deficit because of the increases in world oil prices. Since then, two factors have turned our trade balance in a more favorable direction. First, higher prices, conservation efforts, and expanded domestic production have resulted in sharply reduced U.S. oil consumption and import volume. Second, the U.S. recession has substantially reduced our non-oil imports at a time when U.S. exports are growing strongly. In line with this improvement, we expect the current account to show only a very small deficit in the second quarter, for which complete results are not yet available, and to shift to substantial surplus in the second half of the year. In 1981, with cautious domestic recovery and continuing low oil consumption, we expect a sizable current account surplus.

The U.S. dollar has remained relatively stable this year in foreign exchange markets, depreciating against some major currencies, and appreciating against others. During 1980, the dollar has been virtually stable relative to SDR. The strength of the dollar and its defense from unwarranted speculative activity will continue to be major objectives of U.S. economic policy.

#### The Economic Revitalization Program

Although the transition from recession is expected to get underway shortly, the U.S. economy faces some problems which require a coordinated policy response. Our principal objectives are:

- o To reinforce recovery from the current recession and put people back to work in productive jobs.
- o To revitalize American industry, working in partnership with business, labor and the public.
- o To increase substantially the share of national output devoted to investment in order to create jobs, encourage innovation and improve productivity.
- o To continue the war against inflation so the gains from industrial growth are not eroded.

- o To implement our national energy policy of reducing our dependence on uncertain foreign sources of imported oil.
- o To maintain a sound and stable dollar which contributes to world economic and financial stability and growth.

President Carter has recently announced an economic revitalization program as an important first step in achieving our economic objectives. One of your own proverbs, I believe, says that a journey of 1,000 miles begins with a single step. We feel that we have made more than a single step, but recognize that the full revitalization of the American economy will be a long journey.

The new program is neither a traditional stimulus program nor a general tax cut proposal. It is a carefully targeted series of initiatives designed both to reduce unemployment and to promote greater growth in productivity in the longer term.

The new program contains elements designed to achieve the following goals::

1. Encourage private investment and expand public investment to revitalize America's economy -- so that we can produce more, export more, invest more, and employ more.

2. Create a forward-looking partnership among Government, the private sector, and the public to deal with those national problems that only cooperation can solve.
3. Help people and communities affected by industrial dislocation to make positive economic changes.
4. Offset rising individual tax burdens in ways that do not rekindle inflation.

While you will not be interested in a full review of the details of the new program, these are several special features which deserve brief mention. This may give you a general idea of the direction in which we are planning to move.

The President's Economic Revitalization Board: To reinforce cooperation between Government and the private sector in dealing with the complex issues of industrial policy, the President will establish a new, high-level Economic Revitalization Board, comprised of representatives of industry, labor and the public. The Board will advise the President on the broad range of issues involved in the on-going process of revitalization.

The Board will be requested to develop specific recommendations to the President for establishment of an industrial development authority to provide financial assistance for industrial development and economic revitalization in areas in transition and affected by industrial dislocation and high unemployment, or if needed to remove industrial bottlenecks.

The authority would mobilize both public and private resources, such as Federal, State and local monies and capital from private markets and pension funds. Its programs would be coordinated with State and local development functions.

Encouraging Private Capital Investment: To improve productivity, as well as to provide for the energy resources necessary for our economic and national security, will require that an increased share of our national output be devoted to investment. To accomplish this, the Administration will propose tax changes to encourage investment.

Liberalized Depreciation: A new system of depreciation allowance -- the amounts a business may deduct from its income to recapture its capital investment costs -- will be proposed for enactment next year, effective January 1, 1981. Liberalized depreciation allowances will encourage business to expand investment, to modernize productive capacity and to provide new jobs. The depreciation program will be designed:

- o To provide for a constant annual rate of depreciation for each asset class.
- o To reduce the number of assets and industry classes to 30 or less from the present 130. Few taxpayers would use more than 2 or 3 classes.
- o To simplify the procedures for using accelerated depreciation.

- o To increase the allowable depreciation rate by approximately 40 percent.
- o To allow roughly equal liberalization of depreciation for all assets, thus minimizing economic distortions.
- o To take effect immediately upon the specified effective date, thus avoiding complicated transition rules that tend to delay some investments.

Investment in Energy Security: Continued progress in the energy area is an essential part of the Administration's economic program. Enormous investments in conservation and domestic energy production are required over the next decade to accomplish the reduction in oil imports so essential to our national and economic security. These investments will create hundreds of thousands of jobs domestically and will help protect the jobs of all Americans from future oil price shocks.

Through phased decontrol and the other measures already undertaken, this country has reduced its oil imports by about 20% from their previous peak levels. Most importantly, this reduction has been the result primarily of increased conservation and use of domestic energy resources and not lower economic activity. The amount of energy required per unit of output has been substantially reduced.

Together with Congress, the Administration has provided for vastly increased funding for energy conservation and production since 1977. Over the last four years, to stimulate production and conservation, Congress has approved tax credits which will provide \$4 billion in benefits by the end of FY 1981. In addition, \$20 billion (out of an ultimate \$88 billion) in budgetary authority has been appropriated for the Synthetic Fuels Corporation to assist the private sector in creating a major new synthetic fuels industry. The goal is for synthetic fuels to supply about 2 million barrels of oil per day by 1992.

Research and Technological Development: Technological advance and innovation have accounted for much of the productivity growth in the United States in the past half century. They are essential elements of economic vitality.

In cooperation with Congress, the Carter Administration has increased obligations for research and development from \$26.2 billion in FY 1978 to \$35.4 billion in FY 1981. Basic research spending increased by about 35 percent in the same period, from \$3.6 to \$4.9 billion. In addition, the Administration has stimulated new research programs between industry and universities, encouraged Government-industry cooperation -- for example, in the automotive sector -- and has increased support of smaller high technology firms.

As part of the economic revitalization program, and beyond the fiscal proposals aimed at stimulating investment

and innovation, the President will propose in January an additional \$600 million in budget authority for fiscal years 1981 and 1982 to stimulate research and technological development. With this commitment, funds for basic research will grow in real terms by 3 percent per year.

### The Future Prospects of the U.S. Economy

Revitalizing American industry to provide even stronger growth in jobs and national income in the 1980's will require a new spirit of cooperation among business, labor and Government.

A great strength of the American economy is its primary reliance on the private enterprise system. The cumulative effect of millions of decisions by individuals and businesses within a competitive marketplace is by far the most effective and efficient way to provide for our Nation's needs and wants. However, private industry and workers in America face the challenge of unprecedented change.

The economic world of the 1980's is vastly more complex than that of the 1950's and the 1960's. We have become more heavily involved in international trade and forces influencing the international competitiveness of our industries have taken on increased importance. The pace of technological change has accelerated, creating opportunities but necessitating adjustment. The character of American industry and the work skills it needs are changing. Actions of government at the Federal, State and local levels increasingly affect our industries.

The role of the Federal Government in seeking to revitalize American industry is primarily to create a climate which encourages private innovation and investment and creates permanent and productive private sector jobs. In present circumstances, because of the speed and scale of change in the Nation's industrial structure, Government must go further. It should also help smooth the adjustment process of communities and workers to avoid undue distress and hardship.

In considering the future prospects of the U.S. economy, it is important to recognize its size and diversity and the extent of the changes which have taken place in the past. U.S. Gross National Product is approximately equivalent in size to that of Japan, Germany, and France taken together. Last year the increase in U.S. Gross National Product was roughly equivalent to the total product of countries as sizable as Italy and Canada.

An economy of such size and diversity is not immediately and quickly responsive to minor changes in Government policy. It may be comparable in some respects to steering a very large ship which answers to the helm, only slowly. Still, as we look back over U.S. economic experience, we can only marvel at the changes that have taken place.

In 1900, the U.S. farm population exceeded 40% of total population. By 1950, the proportion was 15% and it is currently below 5%. Mechanization, technological progress, and the natural fertility of the soil have made possible the achievement of very high rates of agricultural production with steadily declining numbers of people employed in agriculture.

That particular source of economic growth -- the shift of population out of agriculture -- has now run its course. The task that lies ahead of us is to revitalize the industrial and service sectors of the economy and make them more productive. American industrial workers are productive, not only because of their own training, education, and enterprise; but also because they work with the aid of relatively large amounts of capital reflecting advanced technology. But in this area, our progress in the decade of the 1970's was not all that it might have been. Therefore, we expect in the United States to place increasing emphasis in the future on improving the incentives for private capital formation.

#### Conclusion

Our economic conditions and yours are similar in some respects and different in others. But our countries share a desire for economic progress and rising standards of living. The expansion of trade and other contacts testifies to our mutual desire for a beneficial economic relationship. Meetings such as these help to establish the broader foundation of understanding upon which we must build in the future.