REMARKS BY
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BEFORE THE
MORTGAGE BANKERS ASSOCIATION
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When I accepted the invitation to be with you today, I expected to be here as Chairman of the Federal Reserve Board. I was the fifth Chairman of Federal Reserve, and I've been demoted to the 65th Secretary of Treasury. It's an older organization, apparently -- or has less job stability.

It was said that I left a very secure job to go to a rather insecure one, and it probably didn't dawn on me when the President asked me to take this job, that it was a very clever way to get me out of the Fed. But at least I'm here today without any responsibility for monetary policy.

If you want to discuss interest rates, forget it -- it's somebody else's problem, so to speak. But I would like to mention a few things about your industry and about economic policy, and I would like to respond to your questions in what limited time we have, because I want you to get up to the Hill and sell the Administration's program hard. So I do want to get you out on time.

The Administration's program, of course, is very coincident with your own objectives. Being in tune with mortgage bankers is part of the process of being in the Administration. Let me mention a couple of things about the housing market that may be of interest to you. It seems to me that you, more than most, are aware that since 1966, economic policy, in responding to business cycles, has used housing as sort of the whipping boy for the business cycle. The process has been that each time there was a period of boom and a coincident rising of interest rates as money supply and demand adjusted themselves -- there was a denial of credit to housing. There was a disintermediation, and the closing of the credit sources.

And that has meant that, as business cycles have gone along over the last 12 or 15 years, housing has disproportionately borne the burden of those business cycles.

In recent periods, some changes have been made, of which part have been innovatious by those who deal in this market, and part new government policies. In particular, it seemed desirable as a philosophy to return housing to the market system and to let it operate like other parts of the economy and be judged upon people's choice of that product, that service, compared with their other choices.

And it's for that reason that the money market certificates were created that allowed the housing industry to, in effect, bid for capital.

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It has meant that we have seen interest rates for mortgages go up, but it has meant that, at least, buyers had the choice of electing to purchase housing, against some other purchasing choice, and have not been denied that option.

Now, this is an important change, and I think it's only the beginning of a fundamental reform that relates to a whole philosophical attitude through the government: that the control mechanisms of the past have worked in prior times, but that in the future we're going to need more market mechanisms to do the allocating and the choosing, rather than arbitrary decisions from Washington. And I think this is a good direction.

For the same reason we do not favor the mortgage subsidy bonds, because allowing these bonds begins to interfere with the market system, and selects the housing sector for subsidy. And I do not know how you decide the equities in the economy and in the society along those lines, because if you are going to have a subsidy for housing, why not a subsidy for automobiles, for appliances or for tennis racquets or something else?

And if you really believe in the private enterprise system, and believe in a market system we ought to do everything we can to unwind the government interventrous and return to a system where, in this period of shortages and limitations, the market is allowed to work, recognizing that the best method of allocation is to let the final purchasers make their choice, based upon the economics of the result.

And that also means that we are concerned about the possibile substitution for the present House bill, which would limit and phase out mortgage subsidy bonds, of legislation that would eliminate mortgage subsidies, but instead provide a tax exemption on interest earned on savings. That is the wrong solution at the wrong time.

There may be a time and a place for looking at how we create incentives for greater savings, and how we deal with compensating small savers more appropriately. But a tax exemption is a bad choice, because it does not really address the fundamental issues. It leaves an arbitrary system, and it means that those who are in the highest tax brackets get the greatest benefits -- those who are the smallest savers, and perhaps on Social Security, and have little or no taxes, get no benefit, -- and so it doesn't work in favor of the free market principle.

So I hope that, in your thinking about these issues, you will be with us and will agree with us that the best thing to do is to create more of the conditions for the market.

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Let me turn if I may, to the broader issue, of our economy and the problems we face. Obviously, the greatest problem we face is inflation. It's a clear and present danger. Inflation has built up over a long period of time and has become a real threat to our well-being. Inflation impairs the growth of real income, reduces real incomes and drives up the cost of job-creating investments. It falls very heavily on those who are least able to afford it, and it breeds the kind of recessions that will ultimately destablize our economy and create great difficulties.

And if one thinks of the kind of inflation rates we have now, and realizes that if they should continue, that in the working lifetime of a young American graduating from college this year, the dollar that we hold today could be worth less than a nickel upon the retirement of that individual, we realize how unacceptable it is to submit ourselves to this level of inflation.

Inflation built up for lots of reasons over about 15 years, and many of them were policies that we could have pursued more intelligently, with greater wisdom. Many of them were external factors that have to do with events beyond our control -- certainly, the weather, the crop yields around the world, are very hard for us as a nation to control, and a hungry world does demand food, and it uses up those resources.

And of course we also have the historic transition in some of the raw materials, where the finite nature of our earth has finally caught up with us. And we have to deal with some limitations. But whatever the reasons for inflation building up, because it's built up such a long time, it's also become deeply embedded. It's not just a cyclical phenomenon. We can't respond to it just by holding the economy back, letting the inflation wash out, and then starting over again. It's deeply embedded in the structure, and that's why we have this very difficult problem of even high rates of inflation in times of recession, because of the underlying structural situation.

And in the face of this kind of problem, it's extremely important that we as a nation develop, understand, support, an integrated strategy to combat inflation -- to wring it out.

And I would like to suggest to you that, over the last year and a half, two years, this Administration has been putting in place a series of major policy decisions which, in their cumulative impact, represent that integrated strategy, represent the marshalling of the policy weapons that are necessary to wage a total war against inflation.

The first of those policy weapons is a new attitude toward fiscal policy. And as you know, it was just a short time ago that we had extremely large Federal deficits and escalating Federal spending. The new direction that is being pursued is twofold -- one is to move as rapidly as possible in an adjustment process, without creating dislocations, toward fiscal discipline and bringing the Federal deficit down to where we get to a balanced budget.

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And we've had a balanced budget only once in the last 20 years. And it's important that we reestablish the norm of balance in our budget, when the economy is operating at an optimum level. That's essential.

Another part of this fiscal discipline has to be a decision to reduce the relative role of Federal spending in our economy. Over the years, we've allowed it to creep up until it reached a peak of 23 percent of GNP going through the Federal government. And we've got to bring that down, as quickly as possible, to 21 percent and below, and as we do that, it means that we can release tens and tens of billions of dollars back to the private sector where cumulative effect of individual decisions on spending and investing will be far more efficient than if we spend the money through the Federal government.

And these directions are important, and the discipline and the willingness to stick with them is critical, even in times of economic downturn.

Now, a second important policy has been to engage in a voluntary program of wage and price restraint, because fundamental policies, such as fiscal and monetary policies, affect the economy with considerable lag. And because of the lag, we can't expect, by a new direction, a new discipline, instantly to bring down inflation. So we need to hold the fort, to bridge over the period between the time when we apply these new policies until they can take effect.

And so a voluntary wage and price program is part of the effort to have a system that serves everyone's self-interest and offers a fair sharing of the burden, without the inequities and the unworkability of government controls, but with a consensus that we all have a stake in it, and that we will work together and moderate our behavior, so that we can buy the time for our more fundamental policies to take effect.

And this has worked. There's no question in my mind -- the evidence is strong that wage increases and price increases in the last 12 months have been less than they would have been, had we not had such a program. And if you take the industrial and service parts of our economy along, and take out food and energy and housing, you will find that the inflation rate has behaved extremely well. We've been able to hold the fort in this period of time, and not had an acceleration of inflation in areas other than food, energy and housing that has been important, because we've been impacted so heavily by these three components.

Another important policy weapon that's put in place is a determination that we will have a strong and sound dollar. The decline of the dollar from September, 1877 until October, 1978 added 1 percent to inflation last year, because of the higher prices in dollars we

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had to pay for essential imports and because of the competitive effect of higher foreign prices on domestic prices.

And that 1 percent ratcheted through existing contracts and programs, and it follows through so that even though we have had a stable dollar this year, there has been a carryover of 1 percent inflation from last year. Thus in two years, there has been a price tag for American consumers of $30 billion, because of the decline of the dollar through October, 1978.

And that is why we moved so forcefully last November 1, and that is why today we have a dollar about 4 or 5 percent higher in value than it was 12 months ago, because we were determined that we'd better arrest that condition, and that we would commit ourselves in fundamental policies and in market policies to a stable dollar. And that will continue to be important policy.

And a part of our international monetary policy is the commitment to bringing our current account into balance. We must, of course, accelerate our exports. We must continue to exploit our international opportunities and we are making enormous progress in bringing our international accounts into balance.

We had a current account deficit in the last calendar year of $14 billion. The deficit this year in our current account will be less than half of that, and next year we will be in surplus. So this policy of a stable dollar and balancing our international accounts is taking hold.

Another important policy is monetary policy. The fundamental weapon of fiscal policy must be coupled with a parallel effort in the monetary area, to add discipline and to gradually bring down the rate of growth in money and credit, so that we starve out the inflationary forces that can come from excess money chasing goods and services.

And this kind of policy was certainly part of the responsibility that Phil Jackson and I had at the Federal Reserve, and which continues to be the policy of the Federal Reserve and certainly the policy of the Administration.

Now, there are other important policies that are in the course of being sharpened and improved.

One has to do with productivity, because in the area of productivity we have been falling woefully behind. For the first 20 years after World War II, our productivity gains ran about three and a third percent a year, which was the basis for annual increases in real income.

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In the last 10 years, we have been getting productivity gains of only 2 percent; in the last five, less than 1. And we cannot expect to continue to have improvements in our national real income, if we do not produce on a better basis.

And part of the reason for our lagging performance is we have fallen behind in our investment. The Japanese economy spends over 20 percent of its gross national product in capital investment, Germany over 15 percent. The United States, if you take both private and public capital spending, spends 10 or 11 percent. We cannot, year after year, decade after decade, fail to reinvest in the vitality of our industrial system and expect to make the productivity gains that are essential if we are going to be competitive in the world and if we are going to have lower unit costs and lower energy costs and all of the other productivity gains we need.

And it's for this reason that we have been trying to begin using our fiscal and tax policies to create conditions where businesses will find it more attractive to invest and more likely that they can make those private investments which will return us to the vitality and the preeminence of American production and productivity that we must have.

We must also unburden our system of the regulation that has fallen upon it and raised costs all along the time. This will take time, because much of the regulation is embedded in statutes, and therefore requires the Congress to help us in unwinding some of the effects. And many, many of the Congressmen are certainly trying and will contributing to this effort.

Finally, I wanted to speak for a moment about energy, because that is a policy area that is critical in this whole integrated strategy to deal with inflation. It is absolutely essential that we reduce our dependence upon petroleum as a source of energy, because of its limited availability in the world now and in the future. It is also essential that we reduce our dependence on imported petroleum. Those are two difference points — we've got to shift away from petroleum itself, and we've got to shift away from imported petroleum.

And I'm talking about petroleum that is available in pools, that can be sucked up with straws. There are lots of other petroleum products that are hidden in very expensive formations, that we'll have to recover — but all these energy requirements have come to roost on us now, and it's very critical that we gain your understanding and your support for an energy program that does accomplish these objectives I've just stated.

And once again, the President has chosen a course of action moving more toward the market system — involving first, decontrol, of

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natural gas through the bill that was passed last year to lift controls on a phased basis so that it does not create an abrupt shock to the economy; and second, his decision in June to decontrol domestic crude oil.

Now, that raises a series of other issues that are now before the Congress, and which are high priority if we are to make progress. The thing that is accomplished by moving to the market system is, number one, we create incentives for conservation because pricing will be related to uses; and second, we create incentives for production, because the higher prices that are inevitable from going to a market system, a world pricing system, will mean that there will be the resources that will justify the investments to find and develop new sources of energy.

But the very process of going to market level pricing, means that very large additional revenues will be generated in the sale of these products. And the question that we need to address as a nation, and are addressing -- the House of Representatives has already addressed the issue and passed a bill -- is how we allocate those revenues among the highest and best uses for our nation.

There is no question that a great part of those revenues should and will go to the producers of petroleum products, who will then use them in their businesses to develop the additional sources and seek additional production, and this is important. But those companies and those firms cannot take on the risk of new technologies with uncertain outcome and uncertain costs. So it's very important that we also allocate some of the funds to develop alternate sources of energy which are now unproven and undeveloped, that private corporations cannot take on, as a matter of their own risk.

And therefore, some of these funds, over the period until 1990, would be allocated through an energy security corporation, for use in financing private sector projects which would help us develop the alternate sources of energy, and which would underwrite the risk in what are otherwise very uncertain ventures. But by spreading the risk among the projects, and by accomplishing the initial breakthrough in technology and production, this will become a private sector activity as it develops downstream.

And in addition to using funds for that kind of use, which is critical, we also need to use some of the funds in such areas as transportation, where we need more mass transit, more public transportation -- so that lessening our dependence upon the automobile and its high consumption of energy, will make a contribution toward the conservation of energy that is essential if we are to meet our goals.

And there need to be some funds allocated to protecting those

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Americans who cannot protect themselves -- the poor, the ones on low fixed incomes, who cannot afford the increases of prices of heating oil and energy, and who need to find some cushion until the whole system can adjust itself to the new structure.

And so I hope that, as you are here in Washington, that you will be able to become acquainted with these policy areas -- that you become acquainted with the philosophy behind the energy proposals, and that you will find it helpful and useful to be supportive of the kind of national decision that needs to be taken on the fair allocation of additional revenues, to the best common purpose and the best common use.

I must say that if one adds this all up, I can summarize it very simply -- inflation is a deadly disease. It's built up over 15 years. It takes a comprehensive strategy and a continuous war to defeat it. Because it has built up so long, it will not be wound down quickly. It will take five, six, seven, eight years of constancy of purpose, steadiness on the policies that go to the fundamental issues if we are to win the war. There is no quick answer, there's no quick fix -- that this is a process that built up a long time and will take a long time to unwind, will test every American as to our character, our will, our determination, to work together -- to unite, to be willing to share a degree of austerity fairly, so that we can, by taking less individually now, be able to reach the greater bounty of our nation as we solve our problems, and as we reemerge as the preeminent America, which we are and will be and shall be.

Thank you very much.

(Applause.)

SECRETARY MILLER: I know you need to go to the Hill, but I'll take a couple of questions, perhaps, on areas of more direct interest to you. Yes, sir?

QUESTION: I hope this is not in conflict with your original disclaimer about commenting on the monetary policy, but it's obvious that (inaudible) recognizing the problems of inflation, has put it straightforward -- in the way that he has impacted, through discount rates and through open market operations -- I'm curious as to why, up to this point, there has not been a conscientious effort to do something about Reserve requirements, which may have more effect upon the money supply, and I would appreciate your comments on it.

SECRETARY MILLER: Well, you know, the question of reserves or interest rates, are opposite sides of the same coin. You certainly can deal with money supply in reserve requirements, but the Federal Reserve is fairly limited in what it can do in reserve requirements at

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the moment, and therefore it's been left more to open market action. The reason is simply this -- that the Reserve structure is statutory, and while the Federal Reserve has the power to lower reserves, and increase reserves to a degree, if you wanted to use reserve action now to restrain money, you'd be increasing reserves.

And right now that means that the member banks would be the only banks burdened by that, and since you have an increasing percent of the deposits outside of the Federal Reserve System, and since there is a desire to solve that fundamental problem -- and it's in the process of legislation -- it would be unwise to exacerbate the problem right now and create a confrontation, until that can be resolved in legislation.

So I think it's a very clumsy time. What we were trying to do at the Federal Reserve, and which Paul Volcker and his associates will be doing now that I am gone, is to complete the legislative process, to get a more universal reserve system, so that the whole financial structure bears it, and with more flexibility, so that there would be the option to use reserve techniques instead of open market techniques, if desirable.

And we must always be prepared to do that, as an alternative.

Phil?

QUESTION: (Too remote from microphone; entire question inaudible.)

SECRETARY MILLER: Well, the whole problem of being disciplined is a series of conflicts, because you're always pressed to let up your discipline for some good cause.

When I came into the Federal Reserve, and you were serving with me, you recall that the Congress was considering a budget for FY-79, which is coming to an end in a few weeks, that would have involved a $60 billion deficit. And you will recall that, through discussion, it was apparent that that was a bad direction to go, because of inflation.

And I think a great deal of credit has to go to the Congress and to the President, to be willing to quickly see the danger and to quickly shift so that the deficit that was to be $60 billion, will come in less than $30 billion -- and that change of direction by $30 billion plus is a critically important decision.

Now, to go back on that, and suddenly start opening the door for deficit, opens the door for every claimant -- for more spending or more tax relief. So I think we have to weigh the desire for incentives, and particularly accelerated depreciation to encourage investment to make the productivity gains I mentioned, against the need for fiscal discipline.

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It's been my judgment that we should study and prepare, and become convience of the direct and effective impact of accelerated depreciation on investment, and be ready, so that when the time comes and there is an opportunity to look at tax adjustments, because we've brought expenditures under control -- then I think we should move.

But it's premature now, because I think even though we need the investment, we need more than that to convience ourselves that we're just not going to keep running these deficits. Do you realize when we entered this decade, the Federal debt after nearly 200 years of our history, and many major wars -- World War II is the biggest expenditure we ever had -- at that time, our Federal debt was $375 billion. And I've got to go testify next week about a ceiling of $859 billion, and that's in less than a decade. And if we keep doing that, the interest on the increased debt in this decade, is more than the deficit by a wide margin, and if you do that decade after decade, you just can't live.

So I think we have to really make up our mind that this is important, and we've got to forego things we would like and, as I say, accept some austerity, every one of us, in exchange for the common purpose we have of getting this nation back on the tract of price stability, full employment, the kind of growth and progress that has been our hallmark for all of our lives, I'm sure we can do it. With your help, it will be done.

Thank you very much.

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