Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
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REMARKS OF
THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE
AMERICAN BANKERS ASSOCIATION
CHICAGO, ILLINOIS
OCTOBER 13, 1980

Thank you for inviting me to be with you again at your annual convention. I am delighted to have the opportunity to talk with you about the economic challenges that lie ahead; and I am gratified by your own record of vigorous response to such challenges.

It is appropriate that we discuss this subject here in Chicago, because this city sits in the middle of our industrial heartland and also stands out as an important international center. It thus reminds us of problems and opportunities both at home and abroad.

A great deal has happened since I spoke with you in New Orleans a year ago. Massive shocks from the 1979 OPEC price increases led to soaring inflationary expectations and interest rates. And these were followed by an exceptionally sharp quarterly drop in output.

As unemployment rose and the housing and automobile industries sagged, there were those who felt the economy was in free fall. They called for immediate stimulation and predicted grave consequences when the Administration declined to intervene. But now it seems that the recession of 1980 may prove to have been one of the shortest on record.

Housing and autos appear to be stabilizing. The index of leading economic indicators has risen for three successive months, and the unemployment rate edged down to 7-1/2 percent in September. Orders and production have firmed and consumers have made needed adjustments in their consumption and credit habits.

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As we read and welcome these signs, several lessons emerge. First, the decision to forego immediate stimulation was correct. Our economy has proved far more resilient than those who urged such measures had anticipated; and a stimulation program would have reaccelerated inflationary expectations and made recovery more difficult. Second, it seems clear that responsible fiscal, monetary and credit policies were able to help break the extreme inflationary fever of last spring. And third, there is every reason to believe that a continuation of such policies can lead to genuine, if gradual, progress in our efforts to reduce the underlying inflation rate.

Now, as we absorb those lessons, it is time for all of us to look ahead -- farther ahead than we have been accustomed to looking in the past, and perhaps farther ahead than is politically popular. While we must, of course, take steps to reinforce recovery from this year's downturn, top priority must be assigned to initiating and implementing policies that will cure longstanding economic ills, both at home and abroad.

The challenges are grave. On the domestic front, the foremost problem is inflation. Kindled by large deficits during and after the Vietnam War and fanned by food and oil price shocks in 1973-74 and again in 1979-80, inflation has persisted despite periods of recession. Today, the economy completes the first year of the 1980's with an underlying inflation rate disturbingly close to the double digit range.

Recently there have been some encouraging signs. Over the past three months, the consumer price index has risen at a 7 percent annual rate. The producer price index for finished goods rose at a 13 percent annual rate during the same period, but moderated significantly in September. These are welcome figures, but it would be a mistake to use them as an excuse for complacency. A number of short-term factors and erratic elements can exert a strong influence on such data.

Accordingly, inflation remains a matter of the utmost urgency. As long as it continues, the incentive to save will be undermined and resources will be diverted from productive uses. And it cannot be stopped unless we build and maintain a consensus willing to attack the root causes of the problem.

A second and related domestic problem is the gradual decline in the growth of our productivity. This results from a number of factors, including an aging capital stock, the presence in the work force of an unusually high number and inexperienced workers, and insufficient technological innovation. The slowing of productivity growth constrains the competitiveness of our goods in the world market.

On the international front, the challenges are equally vast. The global economy is beset by huge balance of payments deficits and slow growth rates. Inflation is high in the OECD countries

and higher in less developed countries. There is widespread poverty, which breeds unrest. Our future prosperity can be assured only if steps are taken to alleviate these problems.

Intertwined in both the domestic and international areas is the energy situation. It contributes to the current account deficits of less developed and developed countries alike. It siphons resources from our own economy. And it causes enormous inflationary pressure.

None of these problems can be solved overnight, and none can be addressed in a vacuum. They are too complex and too interrelated. We will not succeed in the fight against inflation until we make our plants and workers more productive, assure ourselves of stable supplies of raw materials, and reduce our dependence upon imported energy. And we cannot do those things without a sound dollar, a stable international situation and steady growth in the less developed world.

What is needed, in short, is a decade of unprecedented investment--investment in modern plants and equipment, in energy saving technologies, in energy producing technologies, in transportation infrastructure and in development overseas. The immediate yields may seem modest, but the long term opportunities are vast.

You are most intimately involved in one aspect of this task -- the financial aspect. On you and your colleagues in the financial community will fall a major responsibility for continuing to devise more efficient ways of using and channeling capital resources.

I would like to touch on this facet of the problem, but I would fail to convey the comprehensive nature of the task before us if I talked only of this facet. As bankers, and as citizens, you are vitally concerned with the broader situation as well. And as leaders and opinion-makers in your communities you have an important role to play in building the consensus that will be needed if we are to succeed.

At the outset, it is important to recognize that considerable progress already has been made on a number of fronts.

- Prudent fiscal and monetary policies are being pursued to fight inflation. Since this Administration took office, real growth in Federal spending has been held to 1.6 percent a year -- less than the real growth rates that prevailed in the past and less than real growth in the economy as a whole.

- The Administration has been working aggressively to reduce the cost of government regulation. Trucking, airlines, railroads and financial institutions are being

relieved of regulatory burdens. New procedures have been instituted to create a better balancing of regulatory costs and benefits.

- A national energy program has been hammered out for the first time. Decontrol is allowing oil and gas prices to move toward world levels, and oil imports are down 25 percent from their level just three years ago. Domestic oil and gas drilling and exploration, as well as coal production, are now at record levels. And $20 billion of an eventual $88 billion have been appropriated by Congress to help the private sector in creating a new synthetic fuels industry capable of supplying the equivalent of 2 million barrels of oil a day by 1992.

- The Administration has taken effective steps to assure a strong and stable dollar on foreign exchange markets.

On August 28 the President proposed key new steps that are designed to initiate a process of industrial revitalization. The program has four main components.

First, it contains tax incentives that will encourage a major increase in private capital investment. A new simplified depreciation system will increase allowable depreciation rates by 40 percent. And making the existing 10 percent investment tax credit partially refundable will reduce capital costs to firms that have no current tax liability. Together, these measures should increase by 10 percent the share of Gross National Product devoted to capital investment. That means more jobs, greater productivity, and lower inflation.

In addition to reducing capital costs, the President's program would reduce labor costs through a tax credit to offset the employer's share of the January 1, 1981, increase in Social Security taxes (as well as the employee's share).

Second, the program calls for an Economic Revitalization Board comprised of representatives of industry, labor, and the public. The Board will advise the President on a broad range of issues involved in the on-going process of revitalization. Irving Shapiro, Chairman of E.I. duPont, and Lane Kirkland, President of the AFL/CIO, have agreed to act as Co-Chairmen.

Third, the President's program will attempt to ease the human problems that are bound to accompany the revitalization process. This facet of the program includes an increase in economic development funding, a new 10 percent investment tax credit for eligible investments in areas with high unemployment, expanded job training, and additional relief for the unemployed.

Finally, the President's program provides tax relief for individuals. That relief would be targeted to offset the Social Security tax increase, liberalize the earned income tax credit for low income wage earners, and reduce the "marriage penalty tax".

This is a powerful and responsible program. Coupled with determined efforts to build upon past initiatives in the energy and inflation areas, it addresses a number of key domestic problems.

But it is not possible to consider the challenges at home in isolation. More than 12 percent of our economic output now goes into exports. One out of every three acres of United States farm lands and one out of every seven manufacturing jobs produce for exports. And almost one out of every three dollars of U.S. corporate profits comes from the international activities of American firms.

More generally, prosperity here is impossible without world peace, and a lasting peace is attainable only if the significant portion of the world's population now living in conditions of poverty and despair can look forward to growth and rising living standards.

In short, we must do everything we can to help in the global fight against inflation, to stimulate real growth in the world economy, and to aid the developing world.

Drastic changes in the global energy situation have created a huge demand for new, energy-efficient technologies and investments. And there is a general need for new capital stock as well. To meet these investment demands, resources will have to be shifted away from consumption. This can be accomplished only if governments, both developed and less developed, implement monetary and fiscal policies to reduce inflation expectations and encourage fixed capital formation.

For the less developed nations, the next few years will be difficult. Sharply higher oil import costs have been a serious drain on their development capital. They must move swiftly to reduce their dependence on imported energy; and they must develop their agricultural sectors to provide urgently needed food and free up scarce foreign exchange resources.

Substantial OPEC current account surpluses have led to equivalent deficits in the oil importing world, which therefore faces a sizeable external financing requirement. For the more developed oil importing countries, needed financing is often available. For the less developed ones, the so-called recycling problem is urgent. Those with appropriate internal policies and improving external balances may be able to obtain significant amounts of private capital. But others will have difficulty maintaining creditworthiness. They will have to rely in increasing measure upon officially sponsored sources.

In the forefront of efforts to deal with this and related problems are the International Monetary Fund and the World Bank. At the recent annual meetings of the Fund and Bank there was

widespread agreement on the need for an expanded role for these institutions and the specific measures that would have to be taken to enable them to fulfill their growing responsibilities.

The Fund is putting in place a package of measures that will enable it to play a potentially major role in the financing and adjustment of payments imbalances. Substantially greater resources are being committed to support adjustment programs which have a longer-term orientation than in the past. More emphasis is being placed on policies to promote the structural reform -- including increased savings, investment, import replacement, and exports -- needed to adapt to the new energy realities. And an interest subsidy is being created to help the poorest countries take advantage of IMF financing.

The complementary task of the World Bank is to assist in restructuring the economies of less developed countries so development can continue as rapidly as possible. The Bank is already expanding its lending and launching new initiatives to meet the evolving needs of the Third World.

It plans to commit about $14 billion for energy development through 1985, a 13 percent increase over previous plans. It is exploring other ways to expand energy development as well, including the possibility of creating an energy facility or affiliate to consolidate and enhance its activities in this area.

The Bank has also embarked on a new program of lending for structural adjustment which will amount to $600 to $800 million this fiscal year. These structural adjustment loans, coordinated closely with the IMF, will serve as a catalyst for growth and help strengthen the recycling process.

If the Bank and Fund are to perform the work ahead successfully, it is imperative that they have adequate resources. This Administration is committed to ensuring that the United States does its share in providing those resources.

The President has just signed legislation authorizing U.S. participation in a 50 percent increase in IMF quotas, and we are working with Congress to complete the appropriation process shortly. We also will urge Congress to approve the sixth replenishment of the International Development Association and, next year, the general capital increase of the World Bank. Further, we are prepared to join other members in the search for alternative ways to help support both institutions.

The basic picture I have drawn is one of a domestic and global economy seriously in need of capital investment. We can meet those needs only if global investment resources are used as efficiently as possible. To do that the entire financial community will need to develop ever more efficient delivery mechanisms.

Thus far, banks have played an important role in achieving efficiency gains through innovation. As you well know, your initiatives have often helped prod legislators into action. I welcome this pioneering spirit and I believe it can play an important role in the decade of investment ahead.

But I must ask you for more than professional innovation. The tasks ahead are difficult ones and will involve some present sacrifice. Our efforts to address them are likely to attract opposition from those who would prefer some form of quick fix. To stay on course -- to stave off pressure for cosmestic changes and resist those who advance parochial concerns -- we will need your help as citizens and as leaders.

With your help, and with the steps I have outlined as a starting point, I believe the next decade can be one not only of challenge, but of prosperity.

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