

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

January 17, 1979

MEMORANDUM FOR JERRY RAFSHOON

From: Charlie Schultze *CLS*
Subject: State of the Union Speech

On reading the draft I thought that the anti-inflation theme didn't come through strong enough or with enough substance. Rather than try to write alternative language, I tried to set down in the attached note the themes of policy that we are actually following.

Attachment

On the economic front what we are trying to accomplish is the very difficult task of cooling off a stubborn 12 year old inflation without (i) a recession; (ii) mandatory controls, or (iii) dismantling our assistance to those who really need it. That job has been made more difficult by:

- o the recent speedup in inflation
- o the recent sharp slowdown in productivity growth
- o the strong inertia behind a long-standing inflation -- it can't be licked unless our policies are capable of being pursued for a long time. It isn't just one year of austerity.

Therefore, the actual themes we are following in our policies are:

1. Balance. We want fiscal and monetary restraint to cool the economy -- but policies that are not so tight as to lead to recession.

We have to influence private wage and price decisions through voluntary standards, to break the inertia of inflation -- but not with the straightjacket of mandatory controls.

Restraint through fiscal and monetary policies, and the pay and price standards are designed to work together. Fiscal and monetary restraint prevents economic overheating. In this climate, the pay and price standards help us unwind the inflation more quickly.

2. Persistence. High inflation has been with us for 10-12 years. We have tried to break it with extreme medicine in two different ways -- the recession method (1970, and 1974-75); and mandatory wage and price controls (1971-73). Neither method worked. One reason the extremes didn't work is because no democratic nation can stick with such policies long enough to do the job. Controls break down -- the economy is too complex for a bureaucratic straightjacket

and political pressures to dismantle controls become irresistible. Sharp recessions inevitably lead to renewed pressures for large-scale stimulus and there go the anti-inflation policies.

Only with a balanced program, therefore, can we hope to persist long enough to do the job.

3. Competence and compassion. Since we must have a prolonged period of restraint and austerity,
 - o getting the most for every dollar of cost -- in both budget programs and regulations -- is more important than ever;
 - o setting the "right" priorities -- where to cut and where to restrain and where to use the very limited bucks for new ventures -- is critical.
4. Concern with structural unemployment. We haven't lost sight of the need to reduce structural unemployment, particularly among minorities. There are still many people who cannot find jobs even in a high-employment economy.
 - We are still devoting substantial budget resources to this effort, and managing those resources better.
 - Our new programs in this area stress jobs and training in the private sector.

In addition to these points there are sub themes which could be used:

1. As a nation our productivity growth has slowed almost to a halt. The pie (per capita) isn't getting any bigger, and until productivity growth speeds up we cannot increase our claims on the economy.
 - o either through rapidly expanding government budgets,
 - o or through large wage and other income increases.
 - o If we ignore the fact of a slowly growing pie we will worsen inflation by placing too many claims on the economy.

2. In the last 15 years the nation has sharply increased the share of its resources devoted to social programs:
 - o in 1963, Federal budget spending outside of defense and payments for past wars (veterans' benefits and interest on the debt) took up 8 percent of GNP.
 - o in 1978, those same nondefense programs took up 14 percent of our GNP.
 - o we have almost doubled the share. (Figures to be checked)
 - o the hallmark of a competent and compassionate government is no longer how many new ways it can find to expand budget resources for social programs, but, its success in managing existing programs better, concentrating them where they are really needed, and applying careful but compassionate judgment as to where to put the modest increment of additional resources that become available each year.

There are several specific points:

1. Whatever we say about national health insurance, or catastrophic coverage should not be right in the middle of the anti-inflation section, for obvious reasons.
2. We need at least a sentence or two on the "defense of the dollar". I will provide suggested text shortly.