Remarks

by

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In a sense, this is an especially propitious time for me to address this group of business leaders from what you -- and I -- think of as the heartland of America. All of those concerned with economic policy -- the President and his advisers in the Administration, the Congress and its staff, the press and other commentators from academia or elsewhere and not least those of us in the Federal Reserve -- are bracing for the annual outpouring of economic and budgetary messages, days of testimony, and thousands of pages of reports and policy prescriptions.

In concept, out of all that analysis and debate will emerge the elements of policy -- intelligent, coherent, and understood and supported by a wide spectrum of American opinion. In practice, you and I know that ideal can be elusive. The effort is subject to all the frailties of our economic understanding, to all the pressures of political life, and perhaps most of all -- as we are reminded once again -- to all the uncertainties of a world in ferment. Indeed, amid the debate about precisely what should be done here and now, it is easy to lose sight of some of the more fundamental and abiding lessons of our experience. For that reason, as we turn not just from one year to another but begin a new decade, a longer perspective seems to me appropriate as a kind of backdrop against which to consider the immediate issues of the day.

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We can marshall an impressive array of numbers to reflect the accomplishments of the 1970's. Employment grew by about 20 million, as the postwar babies successfully found jobs and enormous numbers of women entered the labor force. We can demonstrate we were better fed and better housed on the average than ever before. While the results are less conclusive, we moved to improve our air and water, our health and safety, and our consumer protections.

But I don't think any of us are deluded by those accomplishments into thinking that the seventies were really satisfactory years for the economy; they were, in fact, the most turbulent economic decade since World War II. Part of the difficulty can, of course, be traced to an unpopular and costly war -- a war that placed both the economy and the political system under strain. The strong thrust of the nation toward meeting our social ideals, with its huge agenda of action toward environmental, consumer, and egalitarian objectives, inevitably had economic costs, and it has not been easy to identify and balance those costs against the benefits. We were forced to face the facts of scarcity of certain resources -- most of all energy -- that we had almost taken for granted and of growing dependence on international trade; adjustment to the new situation has been slow and excruciatingly difficult.

Through it all, there has been a sense of growing uncertainty, of loss of control over our economic destiny. Economic doomsayers have always been with us, but only recently have their scenarios of disaster reached the lists of best sellers. Unprecedented gyrations

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in the price of gold attract our attention; we wonder what it portends, and a speculative climate seeps over into much more important markets.

Much of the discontent and uncertainty can be traced to the strength and persistence of inflationary forces as the decade wore on. Ten years ago, some social thinkers could still defend a little inflation as a kind of social solvent, helping us to reconcile competing and inconsistent social and economic pressures: if the process was admittedly imperfect, it was at least acceptable -- more acceptable than overt policies of budgetary or monetary restraint. Given our historical memories and the easily identifiable social and economic costs of unemployment, there has been an understandable tendency to act vigorously and quickly to take expansionary action, even if those same actions seemed to risk aggravating inflation. And some have felt that, in any event, we could come to live more or less comfortably with inflation -- at some presumably predictable rate.

By now experience suggests otherwise. Hopes for a decline or even levelling of the rate of inflation have often been frustrated. We ended the decade with consumer prices more than double those of 1970, and rising at close to a record pace. Instead of declining, during a time of inflationary pressure, unemployment averaged substantially higher than in any postwar decade. Huge deficits appeared in our balance of trade for the first time in this century, and recurrent weakness of the dollar overseas has undercut other objectives. Real income per worker

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grew only 12%, about half that of the 1960's; productivity growth declined ominously to the point where, for the economy as a whole, it has been hardly visible in the past two years. And, if I judge the national mood at all correctly, after a decade Americans still are not willing to accept inflation as a way of life.

There is a sense in which the 1970's were a decade of disillusionment. We learned by experience that some of the policy instincts and assumptions of the postwar period, however useful they may once have been, have lost much of their relevance in the world of today.

-- We have shattered the illusion that we can, over really significant periods of time, buy less unemployment for more inflation. Looked at over a period of years, both here and abroad, we have seen both inflation and unemployment rise together. The old "trade-off" relationships no longer fit the evidence. Indeed the conviction grows that the distortions and uncertainties inherent in the inflationary process have something to do with sub-par economic performance.

- We have shattered the illusion that we can anticipate correctly the timing of the business cycle a high proportion of the time. But if our forecasts are uncertain, we must be less sanguine about our ability to "fine tune" the

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economy more or less continuously. One clear signal of our fallibility was when the assembled economic wisdom of the nation in the fall of 1974 gave little warning of the imminence or severity of the worst of our postwar recessions; the "recession that wasn't" in 1979 is fresh in mind.

- We have shattered the illusion that the introduction of floating exchange rates could somehow exempt us from concern over our external position and the value of the dollar. Instead, we found a falling dollar could develop a momentum of its own, aggravating our internal inflation, adding to uncertainty at home and abroad, and constraining our ability to lead the Western world.

Still more broadly, our evident dependence on foreign supplies for so vital a commodity as oil has ended any illusions of self-sufficiency. As our exports and imports both grow relative to the internal economy, autonomy in policy is no longer a reasonable premise for action.

- Perhaps most importantly, harsh facts have begun to shatter any illusion that we would take for granted growth in productivity -- the productivity which, in the end, must support rising living standards for ourselves and our children. Perceptions lag. Consciously or not, in our own wage and salary

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expectations and negotiations we still tend to think of significant annual increases in real pay as the norm -- the 3% figure once imbedded in the wage/price guidelines of the 1960's is well remembered. But that approach simply does not fit the reality of the 1% average productivity increase of the 1970's. In fact, under the pressure of declining productivity and much higher imported oil prices, the average worker has had for more than a year to settle for lower, not higher, real income.

I recite this litany not from despair, but because a sense of realism can only contribute to better policy. In the immortal words of Pogo, "We have met the enemy, and he is us." Out of that knowledge can come the understanding and the will to deal more effectively with the problems of the new year and the new decade, with its disturbing mixture of concerns about inflation, recession, energy, and defense.

As we approach those problems, I would suggest first a certain humility in our ability to look ahead and pinpoint the direction of changes in economic activity. Indeed, there is a danger in excessive preoccupation with the relatively narrow question of whether the economy for a few quarters rises or falls by a small margin. Obviously, a prolonged or deep decline would be a serious matter, with important policy implications. But that is not the situation we face here and now. Nor should we assume it has a high probability. In this setting, we should not be diverted

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from the need for policies directed toward the basic requirements for sustaining growth and stability over a much longer period of time.

The experience of last year is relevant. The almost universal predictions of recession went awry primarily because consumer spending was maintained at extraordinarily high levels relative to income, driving savings to historically low levels. We can sense that process can't be sustained indefinitely. But we really don't have any better way today of judging just when the consumer might revert to more normal spending patterns than we had six months ago, or just how sharp the adjustment might be. We do suspect that the growing conviction that prices will be higher in the future than now has affected current spending. But an effort to sustain activity by permitting inflation to take a still stronger hold on the mentality of Americans would surely be counterproductive. The only result would be to push off the risks of inaction to a later time, and make them higher. Meanwhile, a low savings rate, if sustained over time, is incompatible with our needs for investment and productivity.

In these circumstances, the only intelligent choice seems to me, without ignoring the possibility of recession, to develop a combination of policies that offers the best prospects for sustaining growth and stability not just in 1980, but for years ahead. Fundamental to that approach are the efforts underway to deal with inflation through the application of persistent and consistent financial discipline.

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In the best of circumstances, those policies take time to work. Results were not visible in 1979, and certainly we could not have reasonably anticipated such early results from the actions we in the Federal Reserve took last fall to bring the money supply under better control. Moreover, we need to realize that over the next few months there is no real prospect for an abatement in inflationary pressures. The latest round of oil price increases and the speculative activity related in part to the political disturbances in the Middle East have, on the most hopeful reading, set the time-table back a quarter or two. But that setback in no way diminishes the importance of financial discipline: it can only reinforce it.

Monetary policy has a unique role and responsibility to play in that effort. In the end, the inflationary process is related to -- and can only be sustained by -- excessive growth in the supply of money and credit. I can assure you we are committed to maintaining over time the discipline that is necessary to moderate that growth.

There no doubt will be short-run distortions and aberrations in the figures. There are continuing problems of measurement and definition. There may be periods in which the markets may misinterpret our actions. In particular situations we will need to keep our tactics and our methods under review. But none of these things should be misconstrued as a weakening of our resolve and intent: we are not prepared to underwrite more inflation by speeding up the modern equivalent of the printing press.

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I should be clear on one point. Control of the money supply does not mean stability in interest rates. Those rates will respond to such economic forces as the demand for credit and the outlook for inflation. At a time like 1979, when credit demands pressed heavily and inflation moved to higher levels, control on money implied higher interest rates. Indeed, under circumstances like those, efforts to avoid a rise in interest rates by creating more money would in the end have been self-defeating for the result would be another twist of the inflation spiral. The other side of the coin is that an easing of demands for money and credit in a recession period would be normal and could well be reflected in lower interest rates, particularly if inflationary pressures seem to abate. My point is not to forecast, but to emphasize that, in the end, the market will be the determinant, within the framework of a consistent control on money and credit creation.

We know attempts to force interest rates lower by accepting excessive money growth have ultimately proved futile -- but I suspect we would all welcome declines in those rates -- I know I would -- in a framework of monetary control and lowered inflationary expectations.

I have been greatly encouraged in these recent months by the growing appreciation in the Congress, among informed observers, and by the public at large of the importance of maintaining control over the growth of money. I have also been somewhat encouraged by the general trend of events in the fiscal area. I say somewhat,

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advisedly. Obviously, our deficits have been too high for too long, and those deficits have inevitably contributed to pressures in financial markets. What has been less apparent are the persistent efforts that the Administration and many in the Congress have made toward bringing our fiscal house into better order. The seemingly inexorable growth in expenditures, at least relative to GNP, has been curbed. The President's budget, released yesterday, holds out the prospect of further progress of reducing the deficit.

I know as well as you the long distance from budget proposals to actual performance. But I also sense that the need to complete the transition to a balanced budget has assumed a higher priority among our national concerns. As evidence, can anyone recall another time when a president, faced with a forecast of recession, has refrained from calling for large countercyclical spending, a tax cut, or both?

I suspect the real test of our conviction will be seen in the way we, as a nation, handle the tax cut question. The fundamental case for well conceived tax reduction seems to me plain -- and by well conceived I mean the kind of reduction that can stimulate investment and cut costs. I welcome debate about the best way to achieve those purposes and I can imagine -- even if I don't expect -- a business situation that would reinforce the case for tax reduction on cyclical grounds. But, I am also conscious that tax reductions -- however rationalized on structural or cyclical grounds -- will be counterproductive if they simply add to our chronic deficits over time, place still more pressure on

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interest rates, and feed inflation. I see no escape from the proposition that tax reduction must be earned by spending restraint, sustained over time. Put simply, the time has not yet come. That conclusion is only strengthened by the uncertainties flowing from the Middle Eastern situation and the questions about defense spending that are likely to be a matter of debate for some time to come.

That question aside -- a question that must ultimately be resolved on the basis of security considerations -- our recent experience does strongly suggest the importance of moving toward a budgetary situation that does give us leeway for tax reforms to promote incentives to work, to invest, and to save. I can only welcome the growing emphasis on "supply-side" economics -- our disturbing productivity performance demands a response. My concern is that in our enthusiasm, we not neglect the budgetary imperatives. It is because we so urgently need the reform that we must do all we can to speed up the timing by maintaining stringent control on the spending side of the budget.

I will not tax your patience further this afternoon by attempting any review of the energy problem -- except to make one obvious point. The best conceived, most disciplined economic policies are not likely to be convincing in perception or in reality so long as we remain so vulnerable to recurrent and unpredictable massive energy price increases or face shortages in oil supplies. We have debated and hesitated for too long in taking effective actions to reduce that vulnerability in the

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knowledge that the necessary adjustments -- whether enforced by higher prices or by other means -- are extremely difficult.

We all learned on our parents knees that the right policy for restoring health is to take the bad medicine and get it over with. It seems to me time we applied that simple lesson to energy policy! Over the perspective of a decade, the near term pain would be amply rewarded.

I spoke earlier of the disillusionment of the 1970's. Somehow, economic policies improvised by the "best and the brightest" to deal with immediate problems and pain left a residue of still larger problems. If we have indeed learned that we must look beyond today -- if we realize that what we decide now will be important, and probably much more important, for 1981 and beyond than for 1980 -- if we are approaching the 1980's with a new sense of realism and discipline -- then there are indeed grounds not for disillusionment but for optimism. I can only speak for myself -- but that is the mood in which I approach the 1980's.

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