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Remarks by

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Five years ago, when I last addressed the Economic Club, the preoccupation of the day was the acute financial distress of this great City and State. That big black headline in the Daily News--"Ford to New York: Drop Dead"--was not quite accurate. But in its bold and brazen way, it did carry an essential message. Any lasting solution to our economic problems would have to begin, and end, at home.

A month or so ago, I was struck by another headline, this time in a Wall Street Journal editorial: "The Supply Side Saves New York." Somehow, in five years, New York had become an example for the rest of the country to follow.

From pariah to model city--from Daily News despair to Wall Street Journal praise--obviously overstates the contrast. But there does seem to me more than a grain of truth in the proposition that the New York experience has lessons for economic policy more generally.

In the nation as in the city, postwar decades of growth and prosperity nurtured a sense of almost unlimited resources and potential. We turned, en masse, toward completing a huge social agenda: achieving greater equity, cleaning our air and water, enhancing our health and safety, and ameliorating the risks of economic life. And certainly, there has been progress toward those objectives. But these same efforts spawned a mass of regulations, new costs for industry, and a rapid rise in Government spending. Effective tax rates gradually rose, helping to push up costs and prices and blunting incentives, as inflation pulled people into higher brackets. But in spite of the higher taxes, deficit spending became the norm.

Inflationary forces and expectations became ingrained in fact and in our thinking, propelled in part by the energy crisis and other "external" factors but also partly accommodated by financial policies. And there has been a growing sense that, with productivity declining, with money and capital markets under growing strain, and with inflation disrupting orderly planning, the base of our prosperity was being eroded. Relatively high levels of unemployment and slow growth have been visible symptoms of the malaise; yet, it was hard to break out of the policy approaches and attitudes that underlay our problems.

Now, under the pressure of events and in a new political setting, a fresh opportunity presents itself--a new lead and a new vision--for approaching our economic problems in a different way. The whole tenor of economic debate has been transformed, and a new consensus seems to be emerging.

It's almost taken for granted that budgetary cuts--huge by past standards--are not only appropriate but attainable. Not only do tax cuts have a high priority, but discussions of tax reductions focus largely on what is best for incentives and investment. There is recognition of the need to cut back on the maze of regulation and "protectionist" elements in international and domestic policy. And, not least, it is widely accepted that the growth of money and credit must be restrained, persistently and consistently, even when, in the short-run, that may seem to aggravate pressures on interest rates and financial markets. Indeed, I believe there is growing understanding that, over time, prospects for dealing with inflation and encouraging lower interest rates fundamentally depend upon reducing monetary growth.

Not so long ago, every one of those propositions would have been vigorously protested either in terms of economic rationale or political feasibility. But let us have no illusion. The new consensus that seems to be emerging about what can and should be done is a considerable way from being embodied in law and policy. Much depends on how the new approaches are applied. Time will need to pass before we can see the full effects, and hard choices will need to be made.

The proposed reduction in spending is a case in point. I cannot help but be encouraged by the first Congressional responses to the President's program. The chances of bending down the upward trend in spending appears greater than at any time in memory. But let us not forget that the Administration's proposals for fiscal 1982, dramatic as they are, are not the full measure of what the President himself feels necessary in a longer time frame. Defense spending is rising rapidly, and inflationary momentum and high interest rates could threaten achievement of the overall budgetary goals. If the first budget cuts are difficult, subsequent cuts, particularly if they must bear on a relatively small fraction of the total budget, will be even harder.

Yet, as in New York City, it is spending restraint that makes the tax reduction that we need prudently feasible. That is why the budgetary program seems to me the linchpin of the new economic program. It is also why, from the standpoint of general economic policy, it seems to me all the risks are on the side of cutting spending too little.

I know how difficult changing the expenditure trend can be, given the valid commitments to a social safety net and the requirements for defense and interest on the national debt. The search for savings must be broad. It will have to include programs that have been supported by the business community, and to my mind, a re-examination of the rationale and practical operation of the indexing now built into so many Government programs.

Five years ago, New York City and State, with the financial markets closed or closing to them, could not escape the compelling need to cut back spending while stabilizing or reducing taxes. For the United States as a whole, the situation may appear less stark. U.S. Treasury securities, it can be argued, will, in the last analysis be purchased by somebody, and a sovereign nation can theoretically resort to the printing press to pay its bills. But neither circumstance provides a reasonable escape from the need to reduce the deficit.

Money and credit growth needs to be reduced, not increased, over time. In those circumstances, we cannot expect to finance both large continuing deficits and the investment in modernization and expansion needed to support economic growth, to say nothing of housing and other sectors of the economy particularly dependent on credit.

To the extent savings are increased, the potential squeeze on the credit markets can be alleviated. Moreover, the potential for increased savings in the United States should be large. Our personal savings rate has declined to little more than 4 percent of disposable personal income, two-thirds or less of the amounts that not many years ago were considered normal in this country and a much smaller fraction of that of most other industrialized countries. That poor performance reflects to some degree the way we tax savings and investment, a matter addressed by the Administration's program. But it also reflects other, even more pervasive, factors. Consumption has been maintained at high levels relative to income partly because the average worker has attempted to maintain consumption levels as his real income has declined, and partly because expectations of inflation have encouraged a "buy now" psychology.

Viewed in that light, discussions about whether those dollars received directly from tax reduction may be saved or spent may miss the major point. What is more relevant for saving is what is happening to the economy as a whole, and particularly whether there is confidence in prospects for restoring greater price stability and economic growth. In other words, success in reaching the objectives of the whole program will depend upon all the parts, not on tax reduction alone.

Uncertainties about the near-term course of inflation and the economy will also inevitably have a large bearing on the actual budgetary outcome next year. Relatively small differences in assumptions on inflation, interest rates, and employment affect both revenue and expenditures. In recent years, those influences have almost always been in the direction of deficits larger than planned. Prudent caution on that score can only reinforce the need for spending restraint.

We have ample evidence that our ability to foresee the economic outlook over the next few quarters, or a year or two, is limited. The corollary is that the days are gone when we could--with undue pride in our forecasting ability--"fine tune" the economy. By the same token, the success or failure of the new directions for economic policy cannot reasonably be measured by what happens this year or next. What is essential is that the broad outlines of policy be set right, and that it has time to work its effect.

I have emphasized the need for slowing the growth of Federal expenditures, and moving toward smaller deficits as quickly as possible. In that process, we will have to recognize that balance is not at all likely to be achieved in a sluggish economy, with high unemployment. What is critical is that spending and tax rates need to be set on a path that will, with a much greater degree of assurance than in the past, produce balance and a surplus as economic activity returns to reasonably satisfactory levels of performance. That is a feasible, practical goal; yet it is one we did not meet in the decades of the 1970's. It is a goal that seems to me an essential complement of restrained monetary policies.

For most of the postwar period, monetary policy could be fairly characterized as "leaning against the wind" in a cyclical sense, encouraging restraint at high levels of business activity, and expansion during periods of underutilized resources. I doubt that description is useful today. The wind with which we now must be concerned is inflation, and it has been coming at us with a gale force from the same direction for years.

In the current environment, our objective is to avoid accommodating the inflationary process through the creation of money and credit. Put more positively, our aim is to encourage restoration of price stability by reducing growth in money and credit over time to amounts consistent with economic growth.

Ultimately, that approach provides a valid basis--indeed, in the long-run the only valid basis--for anticipating lower and more stable interest rates. In the short-run, the situation can be quite different.

With inflation so strong and expectations so volatile, the significance of a particular level of interest rates--or changes in interest rates--is hard to judge. Our emphasis has turned to quantitative guides--reducing the growth in money and credit. That control is not precise in the short-run. And in a dynamic, changing economy we should not expect stability in all the various money and credit measures from month-to-month or quarter-to-quarter. There was, for instance, a burst of growth last fall in money and credit, as the economy and credit demands recovered strongly from the recession. But the data for recent months suggest the various aggregates, taken as a whole, are again reasonably in line with longer run objectives. The basic thrust of our policy--toward lower rates of increase over time--should not be in doubt.

If other forces are pulling in an inflationary direction, if the Federal Government is generating excessive deficits, if savings remain low, then the implication of restrained credit growth can be congestion and pressures in credit markets. In circumstances like that, restraint on monetary growth is a defense--the ultimate defense--against inflation accelerating. At other times, with economic activity and demand for credit softening, pressures on the market should subside.

Of course, neither of those situations is satisfactory, reflecting as they would the strength of inflationary forces or sluggish business activity. However, attempts to stabilize interest rates at the expense of losing control of the growth of money will not provide a solution. Rather, lower and more stable interest rates will persist only when there is confidence that inflation is decelerating, and that confidence, in turn, is dependent upon avoiding excessive growth in money. But it is also clear the process of restoring price stability will proceed faster and more smoothly to the extent other policies--public and private--are moving in a consistent direction.

In that connection, it is crucially important that market signals and market incentives work in the direction of improving efficiency and productivity and containing costs and prices. Too often, regulatory practices and policies have blunted or undermined those incentives. Different approaches in that area are a matter of urgency. Fortunately, there are already some signs of change. We can build on the example of airline deregulation. We have at least begun to approach the job of applying cost-benefit analyses to our new "social" regulations. But I suspect the most important "regulations" are those we seldom think of in the context of "regulatory reform," and where prospects for change may be less favorable. I am thinking of all those policies that provide protection to individuals or businesses from competition and the inevitable risks of economic life, even when those risks are, in major part, of their own making.

The active debate about restraints on Japanese automobile imports is an apt case in point. There are a number of conflicting considerations. Our car industry is in a difficult period of transition, and the industry can point to Governmental actions that have raised costs and impaired efficiency. But in the end one is forced to ask whether, over time, jobs will be saved or lost in the American economy as a whole, and whether our economy will work better or worse, if we seem to be retreating from a basic policy of open international markets.

We are not dealing after all, with an infant industry or exploited labor. Wages in the auto industry have been steadily rising faster than the U.S. average and now stand 60 to 70 percent above that average. The right question to ask is surely whether the Government, industry, and labor are doing all they can to reduce costs, and to provide incentives to speed the return to quality and model performance that consumers demand. And, overt protection runs the danger of other countries emulating our actions, including protection from our own exports.

We sometimes look longingly at the organized nationwide annual wage bargaining, concentrated at a particular time of the year, characteristic of Japan and Germany. We do not have a comparable framework for reaching a kind of national consensus about appropriate non-inflationary wage settlements. But I suspect there is a more important reason for their relative success. Restraint in pricing and at the bargaining table reflects a conviction that restraint will pay off--pay off in larger markets, more jobs, and general price stability. That conviction can only grow out of experience--out of a sense that prices will in fact be relatively stable, that policies of restraint will be carried through, that something will be lost by inflated prices and wages.

It is that sense of conviction that we, as a country, have lost--but which we are capable of restoring. That seems to me the logic and potential of the new winds blowing in Washington. And it is in that larger sense that the experience of New York must be heartening. Restraint--restraint in wages and costs, in budgets and in taxes--does seem to be paying off--in a better regional competitive position, in some reversal of the ominous loss of jobs in the early 1970's, and in greater resistance to recession.

New York never had access to a printing press or devaluation to solve its problem. That was fortunate. It is an illusion to think that lasting solutions can be found in a debased currency. On a national scale, that is the lesson of the past decade and more.

That is why I see no alternative to our efforts, in the Federal Reserve, to scale back the excessive growth in money and credit. It is not a painless process. Nor is it comfortable to permit competition to work in the economy, or to maintain the budget discipline that the times require. But out of these processes--sustained over time--can come a new sense of conviction and new patterns of behavior that will, in fact, restore both our pride and our progress.

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