Remarks by

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at the

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I am delighted that so many leaders from business, labor, education, and government have joined together tonight for the dedication of this building. I have heard a lot about John Gray — his ability to work with people, to help them to identify problems, to crystallize an approach toward dealing with problems, and to mesh a variety of particular interests into promotion of the common interest. That work has now been institutionalized. There can be no greater tribute to a man than to see his ideas and approaches put in lasting form.

Your presence this evening is an acknowledgment of the continuing need for business, labor, education, and government to understand how their individual efforts must fit together to assure a prosperous future for the Gulf Crescent. You are dealing in this region with a large economy, one that has displayed great vitality in the past, but one also with substantial problems and challenges as technology and the resource base changes. Those challenges have parallels on the national scene. We can all welcome your efforts and your experiments so that we can learn from your experience and hope to emulate your successes!

Of one thing I am certain: the qualities — and in the end they are human qualities of understanding, cooperation, and imagination — that will produce lasting success on a local or regional level will be required on the national and
international levels as well. What I will try to do in the next few minutes is to suggest, in broad outline, how public and private policies need to complement each other in building a more productive economy.

The current economic recovery is, from all outward appearances, a lusty infant on its first birthday -- growing rapidly, gaining in confidence, and generating new hope for the future. Looking back, industrial production has increased 15 percent in the past year, more than 2 million workers have been added to payrolls, and the unemployment rate has come down nearly 2 percentage points. Productivity is growing again, and, for industry as a whole, profits are returning toward more normal levels. Real purchasing power of the average worker has been increasing, and, with interest rates lower, families have been able to reenter the housing market as well as start buying big-ticket items -- such as autos, furniture, and appliances.

It's easy to be optimistic at this stage of any economic recovery -- and particularly this time because the economy has rebounded more vigorously than almost all of us thought likely a year ago. But, after all the difficulties of earlier years, we should be amply warned that we cannot afford to sit back and simply let events take their course. That young infant will need tender loving care -- and consistent discipline -- to grow strongly, and with staying power.
The potential is obvious. The margin of unused resources -- unemployment of both labor and capital -- remains large, as is still so evident in Beaumont and the surrounding area. And, looking further ahead, we have to be able to sustain the increases in productivity we have begun to enjoy.

To my mind, that underscores the fundamental importance of preserving, and extending, the gains against inflation that have been achieved, with so much effort and sacrifice, in recent years. We cannot, in my judgment, build a strong and efficient economy on the shifting sands of a depreciating currency. Inflation is the enemy of orderly planning. It breeds a psychology of short-term gains, of speculation, of neglect of the fundamentals of productivity and efficiency -- in other words, it is the enemy of sustained real growth. More specifically, confidence in the outlook for more stable prices must underlie any lasting decline in interest rates -- one key to keeping the economy moving.

I could recite at length the statistical progress on this front since the days of double-digit inflation -- little change in producer prices this year, consumer prices up less than 4 percent from a year ago, interest rates that -- while still relatively high -- are far below earlier peaks. But I am also conscious that the years of accelerating inflation have
left deep scars -- a skepticism about whether the improvement can be maintained, a continuing temptation to foresee more inflation in wage and pricing decisions, a reluctance to invest long term except at historically high interest rates. The danger is, of course, that those attitudes and behavior patterns can themselves complicate the job of restoring stability and impede growth.

This is one area where actions taken in Washington will be decisive over time. Monetary policy is central to the process of dealing with inflation. Economic theory and experience alike indicate that inflation cannot persist without excessive growth in money and credit; or -- to state the proposition in reverse -- that progress toward price stability cannot be expected without appropriate restraint on the growth of money and credit.

Those fundamentals underlie the strategy and execution of monetary policy -- working toward growth in money consistent with a framework of greater price stability as the economy expands.

Easy to state and hard to do.

Execution involves difficult technical judgments, complicated by the rapidity of change in banking and financial markets that raises questions about the old relationships between money and the economy and about the definition of
money itself. The degree to which we should rely on pre-set rules for growth in money or other variables, as opposed to judgmental adjustments as circumstances appear to change, is hotly contested. The prospect of continuing huge Federal deficits, the financing of which will squeeze other sectors of the economy, compounds the problem.

I will not take the time now to debate those lively issues. Rather, let me assume that monetary policy is directed toward building on the progress against inflation — that growth in money and credit is, in fact, appropriately restrained to that end, as we intend. The success of that policy will not be measured simply by whether we can restore price stability. Eventually, pressed hard enough and long enough, restraint on monetary growth would assure that result. The question will remain as to whether that result can be achieved consistent with economic growth, rising employment, satisfactory profits, and growing productivity during a transition period, and how long that transition might be. The answer to that question lies, in major part, in circumstances outside the direct control of monetary policy itself — but those answers will also inevitably bear upon the ease or difficulty of maintaining a monetary policy directed at restoring and maintaining stability.
One of those areas in question — fiscal policy — is also the direct responsibility of government. We face today a fundamental and growing imbalance between our propensity to spend for public purposes and our ability or willingness to raise revenues. One effect is to keep interest rates higher than otherwise, at the cost of discouraging capital investment. The further risk is, that as the private economy continues to expand, generating larger business demands for credit, congestion in the money markets could precipitate trouble for the economy generally, bringing expansion to a halt prematurely. Relatively high dollar interest rates also pose risks for the international economy, distorting exchange rates and greatly complicating the efforts to deal with the obvious strains on the financial position of so many countries in Latin America or elsewhere.

Our ultimate success or failure will also rest on the responses and attitudes of those in the private sector, reflected in specific business decisions and labor bargaining. My thesis can be summarized in one sentence. The more costs are constrained, the more productivity is increased, the more prices reflect those efficiencies, and the more business converts profits into productive investment, the more assurance we will have that economic growth can be sustained with a monetary framework consistent with progress against inflation.
Moreover, as confidence builds in that approach -- as we see the track record of more stable prices lengthened -- the prospects for sustained low interest rates will greatly improve. That in itself would reinforce prospects for growth, and help keep the process going.

This is not an esoteric matter without relevance to your decision-making, or of arbitrarily asking the private sector to conform in a mechanical way to decisions on growth in money and credit made far away. What is ultimately at stake is our ability to reconcile growth with stability -- and I fear that if we neglect one of those objectives, we will also lose the other.

Put another way, it is a question of promoting our real income and our economic security. It is the extension, across the country, of what you are dedicating to achieve here on the Gulf Crescent.

The obvious question is how we can achieve those results in practice. Part of the difficulty is that so much of our experience over the past decade or two pointed in the opposite direction. For a long while, those who anticipated inflation seemed to be the winners -- they kept their wages and prices ahead of the pack, and they devoted a lot of time and effort to outguessing which commodity or which "collectible" would
appreciate the most. All that seemed much more important than working on efficiency or, in the financial world, those patiently maintaining strong capital or observing some of the time-tested rules of prudent banking or investing.

In retrospect, the entire process was self-defeating for the country as a whole -- inflation accelerated, profits eroded, productivity growth practically vanished, and real incomes leveled off or declined. Strong measures became necessary to check the tidal wave of inflation. In the process, vulnerable competitive and extended financial positions were exposed, jeopardizing both jobs and company prospects.

With those consequences so plain, it's not surprising -- but also highly encouraging -- to see strong new efforts to repair the damage, to cut costs and increase efficiency, and to work cooperatively toward restoring a firm base for growth. But those efforts were born in the crucible of recession. With the economy growing stronger, with many of the unemployed returning to work, with profit margins widening, the most immediate pressures are relaxing. Memories of inflation -- and of failed anti-inflation programs -- remain strong. The temptation to return to habits learned in the previous decade -- to anticipate inflation, to take precautionary steps to protect oneself, or to make up for losses of the past in one fell swoop -- could return.
Looking back, the data over the past year reflect sharp reductions in average wage increases -- half or less of the trend a few years ago. At the same time, recent productivity growth suggests the dismal trend of the 1970's is being reversed. Both of those factors have helped enormously in achieving a sharper reduction in inflation than almost any had anticipated and restoring many companies to financial health. The greater price stability has meant, in turn, that real incomes of the average worker could grow. That is a pattern we need to see extended.

But closer analysis of the data also shows some potentially disquieting signs. Restraint on wages and costs so far has been quite uneven among industries. In manufacturing and construction, where the pressures have been greatest, the trend of wage and other costs -- and prices -- has been relatively flat. However, in some sectors less affected by recession -- finance, utilities, and services (including education) -- there has been less improvement. Increases in wage and salary compensation have remained in the area of six to eight percent or more, far above recent inflation and seemingly signaling further upward pressures on prices in those areas.

As we look ahead in a context of a growing economy, which forces will prevail? Will we see the new attitudes or
cooperation toward efficiency and restraint maintained and spread, or will we see a return to a kind of 1970's mentality of "let's anticipate inflation and keep ahead?"

Well, as I suggested earlier, those of us responsible for monetary policy don't mean to let inflation get a head of steam again. It also seems to me critically important that public policy in other areas helps make that same point plain when governmental action impinges directly on the pricing and productivity of the private sector. Perhaps most important in that respect, we cannot afford to build in artificial protectionist barriers against competition, at home or from abroad, for industries with inflated costs. Where such barriers exist, we should be looking toward phasing them down and out.

In government contracting -- including the administration of the Davis-Bacon and Government Services Contract Acts -- we should not condone a ratcheting upward of wage and cost levels. We need to continue to work at deregulation and more cost-efficient ways of reaching our environmental, safety, and other goals.

In all these ways, government can help provide the right signals and the right environment. But in the end, the performance of the private sector will determine whether we pass -- or fail -- the test of sustained noninflationary growth.
There are two related aspects. Over time, productivity -- broadly defined -- is the crux of the matter; it is a fundamental economic fact that in the long run, standards of living can only rise as fast as productivity. Researchers can suggest in broad terms what it takes to boost aggregate productivity growth -- a skilled work force, up-to-date technology embodied in new investment, a stable economic environment for planning production, incentives to work efficiently together. Economists can lecture that the ultimate result of innovation and efficiency over the years has been to expand, not to reduce, the number of jobs for the economy as a whole. Higher levels of productivity will inexorably find their way into higher living standards for our citizens as a whole -- reflected in better benefits and working conditions for workers and improved profitability for business.

But those are abstractions until they are put together in a specific plant or office. They imply a willingness to innovate and change -- to take well calculated risks. And the hard fact remains that change is never comfortable or easy.

So, the challenge is always, in a company and in a region, to find ways to work together in the common interest -- in full recognition of the fact that if you don't, someone else will, and take your jobs and even your companies in the process. The process always requires understanding -- where education and educational institutions can be of particular
help. It requires a certain flexibility; workers must be willing to take advantage of technological changes that enhance productivity, while management needs to be sensitive to workers' desires for job security and the need for training and retraining. There is a responsibility on both sides to recognize the need for capital resources, and to use them constructively.

We also have to recognize productivity alone will not keep costs competitive -- competitive for a firm, for a region, or for the country -- if we lose control of other costs, and for the nation as a whole, wages, salaries, and benefits account for fully two-thirds of all costs. In this area, we come up against something of a classic "chicken and egg" problem. We can hardly look to labor for restraint if, all around them, workers see the reality and prospect of rising prices. But neither can we expect progress toward stability to be smooth if the upward momentum of nominal wages and costs is excessive -- if it persistently exceeds what productivity can provide in real income.

The fact is we have broken into that puzzle over the past year or two, but under the heavy pressure of deep recession. Both the wage trend and the price trend have subsided -- and on balance the average worker is better off. But our success is incomplete. Far too many have been unemployed. The challenge is to maintain the progress during a more prosperous period.
In the past, we and other nations have tried to deal with the problem through experiments with formal or informal government-imposed wage and price guidelines or controls. To put it mildly, any success has been short-lived; the complexities of our economy and our markets simply do not adapt smoothly and quietly to fiat from above, however well-intentioned. What we have to find are approaches consistent with the realities of the marketplace, and I believe that really means that any lasting solutions will need to be rooted in changes in the approach to labor-management relations at the grass roots -- changes that recognize more fully the fact that interests coincide or overlap as much as they conflict.

I think we can all sense that American industrial relations have had, in the words of one wise analyst, something of the character of an "armed truce" -- and occasionally the word truce has hardly been apt. I suppose an element of brinkmanship is inherent in labor as in other negotiations. But, when evidence of declining productivity or eroding competitiveness is not faced openly and constructively by management or labor well before a bargaining deadline, we can question whether either side -- or the nation -- is well served.

One exception to the "armed truce" mentality is when, typically in extremis, labor and management go hand in hand to government for help -- for protection or subsidy. Too often, the protection sought is from self-inflicted wounds -- long
prosperous industries with wages far above average that have fallen behind in design or efficiency, or both. Then the claims are both unjustified and counter-productive in terms of the interests of the economy as a whole.

I will not pretend any special expertise in an area where the John Gray Institute itself finds its purpose and work. I would simply say that I can sense, from groups like yours, and from the signs of ferment in industry itself, that this is a potentially fruitful period of changing attitudes. And, if we are to be successful, I suspect that lasting progress will grow out of your successes in dealing with practical problems on a manageable scale rather than from any grand plan conceived at the top.

I can't resist, as you deal with this matter, to throw out a few questions that have preyed on my mind as I observe the scene from afar.

I wonder why there has been so much apparent resistance, by labor and management, to planned arrangements for sharing in prosperity or adversity, in the latter instance in ways other than lay-offs alone. I am thinking, of course, of profit-sharing plans or other ways of rewarding workers when things are good, without building in a floor on costs that may turn out to be unbearable when things are not.

I wonder why more companies have not been successful, or have not made the effort, to encourage employee stock-ownership.
I wonder why the kind of openness and common approaches implied by the current strong interest in "quality circles" had to be imported from Japan, and whether the current interest will spread and take hold in ways that fit an American setting.

I wonder if managements have been as forthcoming as they might in taking their own workers into their confidence in frankly discussing their financial results and their planning options and indeed whether, in some circumstances at least, labor members of a board of directors might not be useful.

Perhaps all of that is only suggestive of my innocence in the area. And I suspect many of you can report that, in your own ways, much progress is being made.

But of one thing I am certain.

Our economy can not for long work well with monetary policies designed to restore stability if labor, management, and the public at large plan on, and act upon, an assumption that inflation will accelerate sharply once again. There will simply not be enough money to go around -- to finance the splurge -- and the end result would be strong financial pressures, high interest rates, and stifled growth.

Nor can we reasonably seek an answer to such an impasse by turning on the monetary valve -- by, as the expression goes, validating inflationary expectations. After the experience of the 1970's, markets are simply too sensitive,
and attitudes too volatile, to make inflation a workable solution. "Once burned, twice shy" is an old adage that has lost none of its human validity -- and we have, as a nation, been burned too often.

There is, of course, a much happier prospect -- combining growth with stability. We have made enormous progress toward that goal.

Now we seem to be approaching a new testing point -- whether constructive changes in attitude and performance started in adversity can be maintained in prosperity. I am convinced that the education, the consultation, the cooperation that you have sought in founding the John Gray Institute -- an effort symbolically cast in concrete in this fine new building -- can be a building block in that effort, not just for the Gulf Crescent, but as a part of a return to a long new period of national growth and prosperity.

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