Remarks of

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at the

Alumni Hall of Fame Banquet

of the

Crummer Graduate School of Business

Rollins College

Orlando, Florida

April 10, 1987

Ladies and Gentlemen, it is a pleasure to be with you this evening. I must admit, however, that it was with some trepidation that I came down here, to within the shadow of Disney World. One hears more than occasionally that we in the nation's capital would benefit from getting out "beyond the beltway" more frequently. However, can I really claim that, in coming to this exceedingly pleasant place, I'm really being exposed to the "Real World"? I'm not thinking particularly of the fantasy created nearby by the Disney people. The simple fact is that this part of Florida has been particularly blessed economically in recent years. I suspect that, economically at least, central Florida is no more representative of the nation as a whole than Washington, D.C.

The general prosperity of this community has its special causes and features, undoubtedly including the efforts of many people here tonight. But I also think in some ways it reflects some broader national trends. I hope I can highlight some of those for you in the course of my remarks.

I should, perhaps, begin by emphasizing that the recent period has by no means been one of weak performance for the economy as a whole. In this decade, we have managed both to slow dramatically an inflation that was raging out of control and to create enough new jobs to provide employment for a record proportion of our population. This feat not only puts the lie to the notion, which once had wide acceptance, that there is a meaningful trade-off between price stability and job growth, but it underscores the relative dynamism of our economy.

If you look abroad, at other advanced industrialized nations, you see a truly stark contrast to our record. While we have added about 11 million workers to nonfarm payrolls during the 1980s -- an increase of roughly 12 percent -- the other members of the so-called Group of Ten industrial powers have managed to boost employment by only 3 percent! As a consequence, while we have experienced a downtrend in our unemployment rate since the recessionary period of the early

Eighties, jobless rates in those other countries have remained high -- indeed, in double digits in some cases.

When we talk to our colleagues in other countries, we repeatedly hear accounts of structural rigidities and immobilities that impede adjustment to forces working to change patterns of domestic and international activity. They argue that, owing to those impediments, they haven't the scope to pursue policies conducive to faster economic growth, because it would entail unacceptable risks of substantial acceleration in wages and prices -- and thus serious damage to their basic economic and political stability.

It is not my intention to dwell this evening on an analysis of foreign economies. To be sure, some interesting questions are raised by these self-assessments, questions that have a habit of cropping up in international discussions of policy coordination. However, I make the international comparison on this occasion only as a way of underscoring the potentially critical role of structural matters in an assessment of the performance and prospects of our own economy.

The fact is that we have not experienced what one would characterize as balanced growth over the past few years. I think this probably explains why, despite the impressive gains I have noted, so many people express dissatisfaction today with the performance of our economy. There is a widespread feeling that we have been skating on thin ice and that there is a latent instability in the present circumstances. Popular sentiment is, as history suggests, not always a reliable gauge of reality, but in this case I believe it is. There are today significant threats to the sustained progress of our economy -- some of them more evident than others, but all of them important to identify and address.

Clearly, an economic expansion is never perfectly even, across industries, or across sections of the country. In the present instance, however, one senses a greater unevenness than was common in the past. The list of deeply troubled sectors is truly striking. We all are quite aware, I'm sure, of the devastation of major segments of the agricultural, energy, and mining industries, and of such manufacturing industries as steel, farm machinery, and construction equipment. And the media recount almost daily the struggles of our automobile and semiconductor producers. Moreover, these industrial problems have taken a toll of the general economic health of states and localities dependent on those activities. And, in my capacity as a supervisor of banking institutions, I am acutely aware of the ramifications of this distress for the strength of our financial intermediaries.

Now, it might be argued that the failure of some of our industries to participate fully in the economic advance is simply a reflection of longer-range changes in the composition of activity here and around the world. It certainly is true that, over time, industries wax and wane as technology and consumer tastes change and as what economists call "comparative advantages" shift among countries in the international trading system. This is only natural and, indeed, fundamentally healthy.

But technology, tastes, and resource endowments are not the only factors impinging on economies, and it is quite possible for unhealthy distortions to be introduced. That, I'm afraid, is what has happened in recent years. In particular, a lack of attention to the full range of consequences of governmental policy actions, coupled with an inability to deal effectively with differing interests among nations, has aggravated sectoral difficulties here and abroad -- and given rise as well to political pressures for new actions that would in the end do more harm than good.

It appears clear from opinion polls that the American people feel more than a little uneasy about federal fiscal policy. While economists may construct elegant abstract formulations that lead to varying conclusions about the short- or long-range implications of persistent, large federal budget deficits, most people just have a sense that there is something awry when the government, year in and year out, spends 100 or 200 billion dollars more than it takes in through taxes and other revenues. I think that the experience of the past several years has confirmed the correctness of that broadly held view.

Those who question it tend to ask, "Well, if deficits are so bad, then why have we had sustained economic expansion and declining interest rates?" Not an unreasonable question, to be sure. After all, a few years ago it was common to hear predictions that the huge deficits would put enormous pressure on credit markets as the Treasury borrowed the funds it needed, and that those pressures in turn would raise interest rates and otherwise strain financial markets so that investment would be squeezed and longer-run economic growth impeded. Where, then, did this analysis go wrong?

Well, unfortunately, I don't think that it went completely wrong. But it did miss one crucial point: the openness of our economy to international trade and capital flows. In an open economy, a shift to a more expansive fiscal policy tends to put upward pressure on real interest rates -- that is, interest rates adjusted for expected inflation -- but that pressure is blunted by the response of international investors. Capital is attracted from abroad, which helps finance both private investment and the government's deficit. But, the capital inflow in turn is also associated with an appreciation of the country's currency on exchange markets, which reduces the international competitiveness of domestic industry. So, in time, through this external channel, there is a sort of "crowding out" that occurs -- it is a crowding out of exporters and those competing with imports.

What I've recited admittedly is only a rough schematic, but it does capture the broad outlines of what we've been experiencing in recent years. While we enjoyed for a time the pleasant effects of the fiscal stimulus -- and the process was made all the more favorable by a coincidence of events that made many foreigners especially anxious to move their capital to the "safe haven" of the U.S. -- we have more recently been experiencing the downside effects. Our exporting industries and import-competing industries have been struggling to maintain themselves, and investment that is necessary for the longer-range strength of our economy has been stunted. In 1986, business investment in new plant and equipment was weaker than it has been in any non-recession period in many years. Only the strength of credit-financed consumer spending kept the economy growing. The Orlando area has, of course, been one beneficiary of the propensity of consumers to spend for goods and services.

Many of the workers displaced by our weakened trade position have been able to find employment in the growing sectors of the economy, but a sizable percentage have not, inflicting great emotional strain and often material hardship on them and their families. In this respect, we can perhaps better appreciate the concerns that I mentioned other countries have about the difficulties attending structural change. Even in our relatively flexible economy, major shifts in the composition of activity cannot be accomplished quickly without some significant costs.

As you know, we have had a marked decline in the exchange value of the dollar over the past two years, and this has enhanced the competitiveness of U.S. industry. American firms have begun to regain lost market share -- and they should gain further so long as they do not squander the opportunity in a short-sighted effort to boost profits through higher prices alone rather than through improved volumes.

But, as I suggested earlier, the trade adjustments to changes in exchange rates occur with a lag, and the turn in our external position has not yet become decisive. Export volumes started to rise last year for a variety of goods -- and I suspect that folks in this area have begun to experience a rise in business from foreign tourists who find that their money goes a lot further now in the U.S. than it did a couple of years ago. Similarly, you probably are benefiting from a greater inclination of Americans to stay here rather than to take what has become a much more expensive trip abroad. However, the change in the trend of imports overall has been slow in coming. Foreign firms have made great inroads in establishing product reputation and marketing channels, and manufacturers and distributors have shown a willingness to trim profit margins in order to maintain competitive pricing. Those margins have by now, however, been squeezed severely, in many cases. Prices of imported goods are clearly rising faster than those of domestic products. I expect that the import volume curve is going to flatten perceptibly in the months ahead.

If you are reading me as saying that there is light at the end of the trade tunnel, you are right. Whether that light is bright enough is another matter, and one that in an uncertain world reasonable men and women can debate. The financial officials of the six major industrial powers who met in Paris a few weeks ago concluded that the substantial exchange rate changes that have occurred will "increasingly contribute to reducing external imbalances."

There is no doubt in my mind that a substantial improvement in our external position during the next few years is essential to the strength and stability of our economy. Apart from the sectoral strains we can see so readily, there is also the fact that the counterpart to our huge trade and current account deficits is an inflow of commensurate amounts of foreign capital. We already have become the world's largest net debtor in absolute terms, and even on the most optimistic projections of our trade balance, our external debt will grow substantially before it peaks.

One may ask whether it is appropriate for the world's richest nation to dip so deeply into the international pool of savings. But, on a less philosophical level, one may simply wonder how much longer private investors around the world will manifest an enthusiasm for plowing their funds into dollar assets. At some point, a creditor may balk at extending new loans to a borrower who persists in living beyond his means.

Exchange rates among the major industrial countries appear to be broadly consistent with economic fundamentals if the authorities of these countries follow through on their economic policy commitments. That was the sense of the meeting in Paris in February, and that consensus was reaffirmed at the "Group of

Seven" meeting two days ago in Washington. Greater stability of exchange rates in the period ahead would be highly desirable, but such stability cannot be achieved by exchange market intervention alone. It needs to be supported by further actions in the policy area here and abroad.

I got into this discussion of the trade deficit by noting a concern about budget deficits. I should now close the loop. Logically, one can't argue that just because the trade imbalance has its roots in the fiscal imbalance that the way to cure the trade problem is by curtailing deficit spending. But, given the nature of our economy, an adjustment in fiscal policy seems absolutely essential if the external correction is to be accomplished without appreciable financial stress. Federal deficits absorb savings from the economy, and Americans -- for whatever reasons -- don't save a very large proportion of their income. The large capital inflows that have accompanied the trade deficit have, in effect, financed a large share of our budget deficits. But as the trade deficit diminishes, so too will those inflows, and the burden of financing the government will fall increasingly on the small pool of domestic saving. Only by cutting the budget deficit can we be reasonably assured that there will be enough capital available to support a healthy level of investment in this country.

There is no shortage of verbal commitment to the goal of reducing the federal deficit. The statement from the February G-6 meeting included a commitment on the part of the United States to cut the deficit. That was, in effect, only a reiteration of what is law -- the Gramm-Rudman-Hollings Act, which mandates that the deficit be eliminated by 1991.

We've now been living with Gramm-Rudman-Hollings for more than a year and I think we can begin to see its strengths and weaknesses. The fiscal '86 deficit was targeted at no more than $172 billion and it turned out to be $220 billion. The deficit for the current fiscal year, FY 87, was targeted at no more than $144 billion, and official estimates point to a likely outcome of around $175 billion. The law says that the deficit for the budget year beginning in October, FY 88, should not exceed $108 billion, and the current discussions on Capitol Hill raise some doubts whether we will even enter that period with a budget programmed to hit that target.

To say the least, the process seems to be characterized by a certain degree of slippage. But are these grounds for despair? I think not. There is a great deal of maneuvering going on in Washington with respect to the FY 88 program, but I don't hear anyone repudiating the notion of sustained effort toward reduction of the structural imbalance in the federal budget. The passage of the Gramm-Rudman-Hollings Act symbolized -- and reinforced -- what seems to be an important alteration in the politics of federal budgetry. At the minimum, it has brought a better balance between the pressures to satisfy constituents through generous tax breaks or government outlays and the need to pursue prudent fiscal policy. I would hope, therefore, that -- whatever the outcome of this year's budget deliberations -- the basic disciplines that have been established will not be lost. As much as I would like to see the Congress and the Administration arrive at a package that at least approaches the Gramm-Rudman-Hollings objective, what is crucial is that we come out of the process with a sense that we are firmly on a course of substantial and persistent fiscal restraint.

The federal budget is not the only aspect of public policy being discussed in Washington these days as an instrument to address the trade imbalance and the associated industrial problems confronting us. As you know, there is a great deal of talk about "competitiveness." It's hard to find fault with the notion of seeking ways to enhance the competitive position of American business in the international arena -- especially when a $150 billion trade deficit is staring us in the face. But, as with many things, the way you go about reaching a goal can be extremely important.

Insisting that other countries eliminate unreasonable tariff and nontariff barriers to our exports of goods and services clearly is a good thing; erecting our own barriers against foreign goods and services is not. Working toward international agreement on dealing with trade-distorting government subsidies clearly is a good thing; establishing subsidy programs here to support inefficient domestic producers or declining industries generally is not. Encouraging productivity improvement through development of a better educated work force, fostering innovation through better application of technological advances, enhancing labor mobility through retraining or other short-run adjustment assistance -- all of these are good things.

In the end, however, we must be realistic about what structural policies can achieve with respect to trade adjustment and the time involved. The impediments that exist to U.S. trade -- and they are many -- will be reduced only slowly. It was not a sudden adverse change in structural trade or economic arrangements that led to the tremendous deterioration in our trade account. More fundamentally, our economy already seems to have the distinct edge when it comes to many of the structural traits -- flexibility and domestic competition -- that should be conducive to international competitiveness.

Moreover, we must remain mindful that measures viewed as protectionist invite retaliation. This can easily degenerate into a self-defeating game of tit-for-tat, ultimately threatening the international trading system that, for all its imperfections, has yielded enormous benefits to us and to the world economy over the years. On a political level, the issue of protection bears a fundamental similarity to that of the federal budget. That is, the special interests find it possible -- and profitable -- to mobilize and make their case effectively. The costs of providing the desired benefits are so widely diffused that they are not fully recognized in the political process. In the trade sphere, for instance, efforts to assist a given industry may have the strong support of a well-organized group of advocates. The costs -- in terms of higher prices, reduced options for consumers, and reduced growth in unprotected sectors -- are not always so direct and obvious. The broad population of people harmed often fails to muster political resistance.

We need to address the basic sources of our trade problems and we need to pursue policies that foster efficiency and mobility of resources. Protection is a slippery slope that does neither.

I suppose that I have been thus far a less than perfect dinner guest, spending so much time on such matters as budget deficits and trade problems -- rather depressing subjects in many respects. But let me say that I've found my visit quite encouraging. What I see here is a thriving community marked by the kind of entrepreneurship and innovativeness that is such a source of economic strength for this country. And I see as well a group of alumni who are supporting a school in its efforts to produce graduates that can and will manage business effectively -- that can keep abreast and ahead of international as well as national competitive forces.

We are in a tough adjustment period so far as trade is concerned. But we have a great deal upon which to build. And, I for one am not ready to sell the United States short in our ability to compete.

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