The Economic Club of New York

The Honorable Alan Greenspan
Former Chairman of the
Council of Economic Advisers

David Rockefeller
Chairman, Chase Manhattan Corporation

March 15, 1977

New York Hilton
New York City

Questioners: George W. McKinney, Jr.
Senior Vice President
Irving Trust Company

Richard A. Debs, President
Morgan Stanley International

Introduction

Chairman James W. Davant

Welcome to this meeting of the Economic Club of New York. Our speakers tonight are a former Juilliard student who turned later to economics and a PhD in economics who decided to go into banking. Economics, once known as a dismal science, has seemed more and more to assume the positive attributes of a natural science. Yet there are always cynics. One of them said recently, if the nation's economists were laid end to end, they would still point in all directions. (Laughter)

Mr. Greenspan and Mr. Rockefeller will both be discussing the economic outlook tonight and we'll be all interested in learning the directions in which they're pointing. The question period will begin at the conclusion of the second speech. Mr. George W. McKinney, Jr., Senior Vice President and Economist at the Irving Trust Company will question Mr. Greenspan. Mr. Richard A. Debs, President of Morgan Stanley International and until recently First Vice President of the Federal Reserve Bank of New York will question Mr. Rockefeller. The question period, as always, will be spontaneous and unrehearsed. There has been no previous consultation between the speakers and the questioners that I've heard about. (Laughter)

In the post-Keynesian era of scarcity, more and more economists are harking back to the principles of Artemus Ward. "Let us be happy and live within our means," Ward wrote, "even if we have to borrow the money to do it with." (Laughter) Our first speaker is made of sterner stuff.

He is an economist who believes in economy and isn't afraid to say so. Perhaps more unusual, he is a forecaster who isn't afraid to make unequivocal forecasts. He was our chief economic pilot through the most difficult spell of economic weather in our recent history. And when he left the Council of Economic Advisers less than two months ago, he had won the respect and the gratitude of the nation. So we are proud to be able to welcome Alan Greenspan back to New York where he recently rejoined Townsend-Greenspan & Co. after more than two years of uncommonly demanding and distinguished service to his country. Ladies and gentlemen, Mr. Alan Greenspan. (Applause)

The Honorable Alan Greenspan
Former Chairman of the Council of Economic Advisers

Thank you very much, Jim. I hesitate to admit to this but I did have a little quick conversation with George McKinney. I wasn't terribly interested in the questions he was going to ask me; I was more interested in the answers.

I'd like to start this evening's discussion of our economic future by recalling a little of our recent past. Following the summer lull of 1976, we began to get strong indications that the economy was picking up momentum again. The pace of production accelerated, employment rose, and new orders began to come in at a quickened pace. Perhaps most important, the summer lull tended to drain inventories which had become somewhat excessive in spring. By December inventories had contracted to quite low levels while delivery lead times remained short.

Accordingly, a strong upsurge in economic activity was anticipated for January and in fact that is precisely what we got, for the first two weeks – then the whole economy seemed to cave in. A massive natural gas shortage, something which had loomed on the horizon for a number of years finally erupted in the midst of extraordinarily severe weather, shutting down plants in a number of states.

But aside from natural gas curtailments, production was plagued with physical delivery problems as a consequence of the weather. The Ohio River was difficult to navigate and Buffalo was virtually cut off from the rest of the country. As a result, auto and truck assemblies were cut back sharply and steel's rising production trend was aborted. And the state of Ohio, judging from most reports, apparently came to a grinding halt.

The official canvasses at the time, you may recall, indicated that by the end of January well in excess of a million people had been laid off across the nation as a consequence of weather and natural gas shortages. The economic statistics had all of the characteristics of a series of concurrent massive strikes. We know the consequences of a nationwide General Motors shutdown and we have seen eight-week steel industry strikes on several occasions. But what we had in January was tantamount to four or five major strikes occurring simultaneously.

Although a few commentators became unduly concerned that the economic recovery would become unwound, most analysts I think correctly perceived that we were experiencing was in fact a major weather strike, rather than curtailing economic activity, was tending only to delay and compress it and the strike effect was to be followed by a major rebound as its aftermath.

In any event, it is certainly clear by now that the weather strike is over and in retrospect was nowhere near as bad as many thought at the time. It is not that people weren't laid off – those were actual reports of layoffs – but recent data indicate that the layoffs were generally short-lived, ranging one or two days, sometimes just an afternoon. And in many instances, even payrolls were not curtailed and actual pay continued unabated.

The unemployment rate which had fallen to 7.3% in January and was forecast by many to go up as much as a full percentage point in February got up to only 7.5% and that's hardly a rise at all considering the extent to which the January figures had dropped so abruptly. What has become evident from the data is that we weather the storm, so to speak, with very little near-term damage to the recovery. Production levels recovered rapidly after the first week in February. And for the month as a whole, according to the figures just released this afternoon, industrial production in February was a full percentage point above the average for January, and they even revised up some of the January data. It's also quite likely, just judging from the weekly pattern of this production comeback, that the March figures will also be higher.

I don't believe it's an exaggeration to describe the current state of the economy as analogous to a coiled spring. Inventories have been drawn down and are very low in terms of days' supply. Contract and awards for plant and equipment continue to advance in a fairly solid fashion and backlogs are building up. Construction activity in the north has been severely curtailed, but little will be cancelled. It has just been delayed and bunched up implying a good deal of pressure to accelerate projects as we move into the summer months and early fall.

This is not to say that the freeze and the natural gas shortages have not created unrecoverable economic losses – unquestionably they have. Just to keep operating under the conditions that existed in late January and early February, many companies had to engage in a number of costly improvisations which have put pressure on profit margins. These loss profits are not going to be made up.

Nonetheless, with production accelerating, profits are likely to come back very briskly on a nationwide basis. It's hard to realize that we are still at levels of profits that minor changes in economic activity create very rapid percentage changes in profits. We are going to see very large numbers in the next several quarters. But remember, in part what's causing it is that the level of profit margins are quite low and therefore small changes in margins generate very large percentage changes in profits. It's merely a recovery back to margins which have become sort of normal for the mid-1970s which compared to the 60s is very low indeed.

Certainly in the last month or two, as a consequence of this extraordinary weather condition, price increases have become larger than we had expected earlier. The Florida freeze considerably damaged the fruit and vegetable crop and these prices generally have increased sharply at both wholesale and retail levels. Fortunately, this type of price increase is temporary since there are numbers of vegetable crops around the country each season.

The real danger to food prices, however, is not in the fruit and vegetable area, but in the Grain Belt where one hears rumblings of inadequate subsoil moisture affecting crop conditions. If we do get severe drought, it will be a more difficult problem to hold food prices in check. So far, however, the future's markets haven't reflected such concerns and anybody who thinks he can forecast food prices better than a futures market does so only at very considerable risk. These markets currently imply that food price rises are going to be moderate and that the drought is likely to be minimal and should not cause prices to accelerate.

Indeed, retail food price increases already seem to have simmered down. There was a big increase in retail prices in January and another in early February, but since then retail food prices appear to have flattened out. If the early indications of this are correct, then the weather impact on food prices may already be at an end, provided of course we don't get further deterioration in the Grain Belt.

All price increases, however, are yet to peak. Gasoline prices should continue to move higher largely as a consequence of the price increase that OPEC imposed on January 1. But higher crude oil prices cannot work their way through into product prices before the early spring, hence we still have several cents more to add to gasoline prices between now and summer. Home heating oil prices were under upward pressure at winter's peak but demand is now on its way down and distillate oil prices are no longer a major factor in the price indexes.

Accordingly, in the food and fuel area the first-half inflation rate is clearly going to be a good deal worse than had been expected and very probably signals the end of the unwinding of inflationary pressures experienced from the end of 1974 through the end of 1976. However, the most recent turn of events does not yet appear to be the beginning of a major acceleration in the rate of inflation. While there is evidence of increases in the underlying cost structure of business, they have not as yet taken on worrisome proportions.

Aside from oil prices, the advance in prices of imported goods during the past year has been moderate and shows signs, at least for the period immediately ahead, of remaining so. If we consolidate domestic business, material transfers cancel out and we are left largely with labor costs, depreciation, taxes, and interest costs. And as a consequence, we get down essentially to the hardcore of any particular set of cost increases, being at least for the nation as a whole, essentially increases in the cost of labor.

For the last year, really from February 1976 through February of 1977, compensation per man hour for all wage and salary workers in private non-farm establishments increased 7.3%. That's actually quite a low number in the context of the recent past, although admittedly when you go back to the period of the 60s, it's an extraordinarily large number by comparison. It is true that the rate has quickened some in recent months but we still don't have evidence of any significant break in the pattern of relatively moderate wage increases that have prevailed over the last several years.

The only data that we have which gives us any real insight into what wages are going to be over the next year are the collective bargaining agreements which cover the approximately 10 million workers for whom data are collected and analyzed, and these account for approximately a fifth of the total production worker labor force. But they, nonetheless, being larger unions tend to be quite influential in the pattern of wages that become developed.

And if we look at these data and analyze what those contracts say, we find for example that approximately half of the 10 million, about 5 million, are due for contract renegotiation this calendar year. Having looked at a number of the various contracts, we come up with a figure of an increase for the first year of these new contracts, excluding fringes, of approximately 9%. That's beginning of year to end of year. This, I might add, compares with approximately 7.8% for a similar group last year. The other half, that is the other 5 million, are due to get deferred increases in the second and third, and in a few instances, the fourth year of continuing contracts.

And those schedules, excluding cost of living escalators, amount to approximately 6% for the year. So that the 10 million as a group, excluding cost of living escalators, averages out to an increase of about 7 ½%. Assuming that the cost of living goes up in the area of 6%, a little bit more this year, that would tack on about an additional percentage point and a half so that what we get overall is an increase of approximately 9% from the end of 1976 to the end of 1977 for the wage change of this 10 million group.

Now analyzing the smaller unions and the non-union, which is by far the largest, we conclude that that group will go up somewhat less than 9% and that overall, when we add fringes back into the total, and I might add that it's really extraordinary the extent to which such things as rapidly increasing health insurance costs and pensions are really moving the compensation figures. It's really extraordinary how big those numbers are becoming. Combining all of that together gives us an increase overall of approximately 8.2% for average hourly labor costs for all American industry. Between the fourth quarter of 1976 and the fourth quarter of 1977, this is roughly a half a percentage point higher than the previous four quarters. So there's some very modest acceleration.

But we have to remember that the acceleration in wage costs are going to be occurring in the context of very rapidly expanding production. In fact, our forecast for the next six months is an increase in the real GNP at an annual rate in excess of 7%. This is a very substantial acceleration and what it will do will be to pick up major increases in output per man hour. That's almost inevitable because when increases of aggregate production occur at that rate, you get a dramatic increase in productivity, and as a consequence, you tend to smooth out the increases in unit labor costs which reflect obviously the increase in average hourly labor cost divided by output per man hour.

So that even though we see some increase in unit labor cost over the next nine months, it's not enough to get a confirmation of any significant acceleration in inflation. Unless you get prices increasing, unit labor costs increasing, and money supply increasing at an exaggerated rate for a relatively protracted period of time, you don't have the signals of a renewal of inflationary forces. And at this stage, while we do see some acceleration occurring, it is not yet a major issue. What we can say is that the decline in the rate of inflation is over and we're now starting perhaps on our way back. But the second half of 1977 is probably not going to be particularly bad on the inflation front and we may be fortunate enough to get through the first half of 1978 without any really significant quickening of the wage price pattern.

But to presume that inflation has finally been snuffed out is, to say the least, an exaggeration. Over the long run, inflation is essentially a financial phenomenon. It cannot exist unless the money supply is increased at a rate adequate to accommodate the acceleration in prices. Outsized money supply growth usually does not occur unless there are very large federal deficits to be financed during the same time period that business credit needs are also rising. In such a period, the aggregate credit requirements of business and government exceed the normal savings flow which the economy throws off. In a sense you overload the system. Potential borrowers who have been crowded out, so to speak, apply to their commercial banks for loans, and to meet this demand, the banks are forced into the money markets to bid for federal funds tending to drive up short-term interest rates. The Federal Reserve, in an attempt to suppress at least temporarily the rise in interest rates, generally creates additional reserves, that is federal funds, which invariably leads to an expansion of the money supply.

While in the short run policies appear to hold interest rates down, a year or two down the road the excessive monetary expansion begins to push the general price level up. One of the reasons why the Ford administration was so strongly committed to getting the federal budget balanced as quickly as feasible was an awareness of the critical necessity of reducing Treasury borrowing requirements if the underlying inflationary forces are to be finally defused.

Until recently we seemed to be making considerable progress in this area. In 1974, Congress passed the Budget and Impoundment and Control Act which created budget committees to rationalize the congressional fiscal processes. Until then, each committee went its separate way adding new spending programs to already bloated budgets and cutting taxes even when large deficits loomed. They had seemed unconcerned or unaware of what the sum of their individual actions could do to the economy.

The Budget Reform Act initially seemed to be working well. The accelerating rise in federal expenditures began to flatten out. And since the spending ceiling was binding on the Congress, there was considerable reason for optimism about the future. But as everyone knows, the Congress can always undo what the Congress has done. Overriding their own legislation, they have recently now sharply increased their previously enacted expenditure levels for fiscal year 1977.

Thus, while it may be argued that the fiscal 1977 budget is a special case, as in fact has been done, I sense an element of creeping skepticism engulfing the new budget process. Certainly the last thing we need at this moment is additional fiscal stimulus. It really makes no sense in the context of what's happening in the economy. The Ford administration in its closing days proposed tax cuts for the purpose of offsetting the increase in the tax burden that results when inflation pushes taxpayers into higher tax brackets. We were trying to keep the tax rate essentially unchanged for the average family. If you don't cut taxes periodically, you in effect are raising the basic tax rate on each family's real income. And that is essentially the type of proposal which former President Ford initiated in his last budget message. Economic stimulus, per se, was not the goal of his budget.

The major component of the Carter administration's proposal was originally a one-shot tax rebate for everybody. That has now apparently been changed by the Congress to $50 per person; to a $50 per person income maintenance payment because they've cut off the level at which actual payments can be made. It is not a tax rebate. A tax cut, or even a rebate, should have some relevance to a person's tax liability which clearly this proposal does not. It's actually an expenditure. The only thing that makes it a tax cut is that the official bookkeeping reduces the receipt side of the budget rather than increasing the expenditure side.

More importantly, I think the precedent of this thing is bad. This type of program is politically habit-forming. It's just too easy already to hand out money one way or another. I think Russell Long said the other day this proposal is like taking a bushel-full of $50 bills to the top of the Washington Monument on a windy day and spraying them out to the populus at large. You know, that may not be profound economic judgment but as an economist I have a certain sympathy for that point of view.

I feel that if we get into this type of activity, that we are sowing the seeds really for continuing large federal deficits. Having removed from the Ford budget the proposals that would have enabled the federal government to reach budget balance by fiscal 1981, President Carter now has no way to do so, short of a politically unacceptable degree of fiscal restraint in his next two budgets.

However, unless these budget deficits are brought down, then as private credit demands begin to expand, as they very probably will, we risk encountering finally a real credit crunch in our markets. Not this year, and very likely not even in 1978, but the danger flags are now rising for 1979 and it's none too early to get control of the economic policy which could generate that type of very unfortunate event. Should it happen, interest rates would move up sharply restraining capital investment which is the one major area of the economy that truly does need stimulus. We have very large capital investment requirements for the next five years if we are to return to a stable, non-inflationary environment. Such outlays will be forthcoming and can be financed only if we eliminate the inflationary bias inherent in the budget process and reduce federal borrowing requirements sufficiently to leave adequate savings at reasonable interest rates for business to meet its capital requirements.

It is certainly true that by all available capacity measures there is significant slack currently in our economy. There are very few bottlenecks now and there may not be many for the next year or so. But we are close to being overdue in getting an overall policy plan in place which will not interfere with adequate capacity being on stream when we do need it. The lead time on capacity expansion, as you all know, is not terribly short.

I'm particularly concerned about adequate energy capacity especially for electric power. As we start now to curtail natural gas utilization, we are observing a marked increase in electric power use. We have even had some winter power shortages recently when typically this problem occurs in the summer only when the air conditioning loads are greatest. There are many problems and risks associated with energy expansion. Nuclear power has a number of risks associated with waste disposal and weapons proliferation. Massive expansion of coal production and use risks environmental deterioration.

But we are going to have to take risks which ordinarily we could afford to avoid since we need every energy source we can find. There are no options. We don't have the choice of whether we expand solar or nuclear. We need both and more. We don't have the choice of expanding energy supply or curtailing its use. We need both. It has come to the point where the types of risks we choose to take are what is going to be open to debate, not whether we choose to take risks. We, as a nation, no longer can afford such luxuries.

Accordingly, it's going to be a much more difficult business environment in which to function in the next ten years than it was, for example, in the decade preceding the onset of the Vietnam War acceleration, the years 1955 through 1965. It is going to be a period of very difficult economic policymaking – not only for the Carter administration, but for their successors as well. It's going to be difficult both in the domestic area and especially so in the international economic area.

As a nation, we have placed too much emphasis in recent years on looking for the quick fix, the short-term solution, the short-term benefit without asking what is the cost. The Congress is skilled at passing legislation conferring short-term benefits on its constituents without evaluating the inevitable long-term costs that their programs create. I'm, in fact, hard-pressed to find any significant legislation passed in recent years which can be characterized as having short-term costs in the name of long-term benefits.

We have come to the point so far as national economic policy debate and dialogue are concerned where we have to make a major shift in the way we conduct public policy. This country cannot function with its focus restricted to the short run. We must recognize that this country has a long history behind it but a still longer history in front of it, but that future can only be as extraordinary as our first 200 years if we have the knowledge, the courage, and the conviction to take a long-term view of our problems and create legislation which emphasizes long-term rather than short-term benefits. With that type of policy, we can make this nation's next 200 years as great as the last 200 have been. Thank you. (Applause)

Chairman James W. Davant: Thank you Alan Greenspan. That is striking about David Rockefeller's career is the breadth and the balance of his concerns. He is the Chairman of Chase Manhattan, has devoted a major part of his life to banking. Yet he has also been a scholar, a soldier, a public servant, a philanthropist, a diplomat – in short, he is something of a complete citizen. He is deeply involved in international affairs as chairman of the Council on Foreign Relations and through service on a dozen other international organizations. And he has also been deeply and constructively involved in his own backyard as a founder and chairman of the Downtown Lower Manhattan Association and as secretary early in his career to Mayor Fiorello La Guardia. He has played an important part in science and education as chairman of the Board of the Rockefeller University. And he has been equally concerned with the arts as a founder of the Business Committee for the Arts.

He is both a believer and one who acts on what he believes. I've felt for a long time that if

Americans lose their confidence in our free enterprise tradition, it will not be because of what businessmen have done, but because of what businessmen have left undone. We can scarcely do better than to follow the example of our next speaker. Ladies and gentlemen, Mr. David Rockefeller. (Applause)

David Rockefeller

Chairman, Chase Manhattan Corporation

Thank you very much Jim. Dr. Greenspan, distinguished guests, ladies and gentlemen; it's a great pleasure for me to be here this evening, to have the privilege of addressing this very distinguished audience. For 70 years, the Economic Club of New York has served as a kind of barometer of national business thought and a catalyst of spirited economic discussion. I might say that my own last appearance at this redoubtable gathering was in 1961. I reported to the Club at that time on what I had thought the future held for gold, the dollar, and the free world. Evidently, I was so far off my predictions that it's taken the Club some 16 years to build up its nerve to invite me back. (Laughter) But I have said that no matter what your motive may be, I'm delighted to be here this evening.

This evening, I would like to discuss with you a deep concern that I have, first as a banker, second, as a member of the business community, and more broadly as a private citizen who firmly believes that in spite of the intermittent difficulties that we've had, our competitive enterprise system is healthy and is serving our citizenry well. The essence of my concern is a feeling that our mass media in particular have not presented fully and fairly the condition and performance of American business. I fear that this could lead to a serious misconception of our free enterprise system by the public, with the system's credibility, and the public's confidence hanging in the balance.

As Tom Murphy of General Motors recently put it, the clock is running on free enterprise and it's later than we think. At least part of the blame for this, as Tom has said and I agree with him, lies in our own business community and perhaps our own organizations. Our critics are active already in the marketplace for ideas. And if we fail to join them in debate, their belief will prevail.

That's not to say that speaking out is a simple task. Most of us in business are far more skillful in selling products than in marketing ideas. Then too we're frequently constrained in what we can say for competitive or legal or customer confidence reasons. Indeed, there are some issues on which prudent business policy dictates that we say nothing at all. Yet I'm convinced that our abstinence from comment too often deprives the public of the perspective that it badly needs to accurately assess complex business-oriented issues. And I believe the time is now for each of us as concerned business people to begin to speak out for our system and the institutions which compose it.

I might note parenthetically that just last evening, none other than the distinguished publisher of the New York Times, Punch Sulzberger, urged members of the Detroit Economic Club to, and I quote, "do some complaining and fight for your rights as business people." This evening I'd like to follow Mr. Sulzberger's advice by examining two banking-related issues which you are probably already familiar with.

One is the subject of the so-called problem banks. You may recall that last year at about this time America's newspapers' headlines and nightly TV news shows were dominated by a spade of dramatic stories about banks allegedly in trouble all over the country. Understandably these stories shook the confidence of the American public in our financial institutions at a time when confidence was badly needed. More recently, the subject of banking problems has reappeared in the press and in the form of bank lending to foreign borrowers. And as before, if not yet as dramatically, this story too has made its way to the front page in an increasingly foreboding way.

To gain some perspective on these issues, let's look back briefly to the problem bank story that emerged in January of 1976. It began with an article emblazoned across the front page of the Sunday Washington Post which centered on Chase and Citibank. Basically the story concerned a then 18-month old confidential report of the comptroller of the currency obtained through unnamed sources which reportedly labeled both institutions as problem banks due primarily to classified loans. Reactions from the banks, the comptroller of the currency, the chairman of the Federal Reserve Board, was immediate and unified in its denunciation of the newspaper article and its implication – the implications that it suggested for the soundness of the U.S. banking system.

Nonetheless, the damage was done and the media across the country joined in on what appeared to be a blockbuster story. Two days after *The Post* revelations, *The New York Times* rushed into print with a one-year old Federal Reserve Board list also for internal uses only of 35 problem bank holding companies. Some days later, a similar FDIC list of 300 problem banks was revealed. Television anchormen warned of, and I quote, “impending erosion of confidence in the banking system.” And on Wall Street, where the gallows humor always seems to run high, local bars introduced a new recession cocktail, “Banking on the Rocks.” (Laughter)

To the casual newspaper reader and TV viewer, and I should like to add unfortunately also to foreign financial markets, these stories could not help but indicate that the banking system was clearly in a shaky condition. To many, in fact, it probably appeared that the press had uncovered a scandal which in financial terms was the equivalent of Watergate in political terms.

In the next several minutes, I’d like to revisit this issue to put it in the kind of perspective which I feel was largely overlooked in the original reports. I asked our staff at the bank to analyze a number of the largest banks reported to be on various problem lists – 19 in all including the original two reported on the comptroller’s list and the remainder from the reported Federal Reserve list.

All were analyzed on the basis of their annual reports of 1975, the same year which was reported to be on a problem list. And here in summary form is what we found about the 19 so-called problem banks. Their assets totaled about $180 billion and their net earnings for 1975 totaled approximately $800 million, even after providing over $1 billion in reserves for possible loan losses. During the year, they paid out in dividends approximately $320 million to literally hundreds of thousands of shareholders across the country and abroad. These shareholders invested more than $7 billion in equity in the institutions and they gainfully employed approximately 150,000 men and women who earned salaries totaling approximately $2 billion.

These figures, I would think you would agree, are not unimpressive. And what are the loan losses – the primary concern of media doomsayers? Loan losses for these 19 banks in 1975 totaled almost $1 billion – a huge number indeed. But again, to put things in perspective, there are two other even larger numbers which must be taken into account if we are to truly understand the loan loss figure. One is the reserve for possible loan losses which totaled $1,050,000,000 for the 19 banks at the end of 1975. Moreover, total loans for these banks aggregated approximately $105 billion, or put another way in this admittedly difficult year for banking, total losses of those so-called problem banks were less than 1% of the aggregate of their loan portfolios.

In all fairness, I should note that one bank on the list did slide moderately into the red, another broke even for the year and yet another did not declare a dividend. Indeed, the problems of the recession had an adverse impact on my own bank's earnings as well. However, far from revealing a group of problem banks, these numbers, if properly understood, point to a group of vital and dynamic institutions and to a strong banking and economic system. And the real news, at least to me, is the ability of that system to absorb such a high level of loan losses while still recording solid earnings and building a strong capital base.

Shortly after the problem bank stories, *Washington Post* publisher, Katherine Graham, addressed the Conference Board and called on the business community to demand coverage, that as she put it, is accurate, fair, and grounded in a real understanding of events. Business credibility, she said, adds up to focusing on honesty, perspective, and performance. Well, I must say, I agree completely with Mrs. Graham. However, it's precisely this need for fairness and perspective which comes up so wanting in the media's treatment of the problem bank stories that I've just referred to. For example, I question the fairness of headlines giving 18-month old data taken out of context across the front page of leading newspapers as though it represented an accurate, balanced, and current picture of the condition of the banking system.

As to perspective, I think the problem banks episode is an example of the media's failure to provide the public with enough information intelligently to assess the issue. For example, when banks chose to stay with their borrowings during the recession, rather than to set off a chain of foreclosures and bankruptcies – not to mention job losses that would have plunged the country into a major recession – few journalists offered this perspective. When banks were caught between the Scylla of congressional demands for credit allocation of socially-responsible borrowers, and the Charybdis of political prize for conservative lending policies, the media offered scant perspective.

Even today, with the banking system well on the road to full recovery from a severe and deep a recession as we've had in 40 years, there is little, if any, perspective from the Cassandra commentators who told us about the problem banks.

Now let me make it clear that I'm not downplaying the problems that the banking system has experienced during the recession. Banks did indeed have problems. In some areas, in all candor, we're still digging out of those problems. But suffering a bad case of flu is a lot different than having an incurable disease. And taking risks is the very essence, I would claim, of our free enterprise system. Those of you in this audience who invest in products that may never reach the market, or a search for natural resources that may never be found know what risk taking is all about.

A bank that is willing to take legitimate risks in lending to individuals or small businesses and giant corporations alike ensures the growth and development of our free market economy, which by definition creates additional jobs for the American people. Now lest I be misunderstood, let me state unequivocally that I am a strong advocate of the right of freedom of the press in a democracy. But I also advocate a philosophical position that any freedom carries with it an inseparable sense of responsibility. The media, it seems to me, if they are to serve the citizenry responsibly, must therefore seek to sharpen the comprehensiveness of their treatment, strengthen their capacity to follow up events, and enhance their ability to help the public understand what one event means in relation to another.

This challenge to a higher standard of journalistic performance leads me directly to the latest wave of problem banking stories – concern with foreign lending of banks. Three years ago, you will recall that the media raised the spectre of imminent disaster for the oil-importing countries and consequently for the international banking system due to the huge surpluses which were piling up in the oil-exporting countries. The more extreme voices in the Fourth Estate predicted the system's collapse under the enormous recycling burden.

There were a number of us at the time – lone voices in the crowd I'm afraid – who argued that the private market could bridge the financing gap for some time, but that over the longer-run, greater recycling assistance would be needed from public sources – as well as strenuous efforts by both the deficit and surplus countries to reduce the need for financing. When the predicted petro-dollar catastrophe failed to materialize, in no small part, due to the immediate and skillful role of the private banking system, the media seemed to lose interest in the subject. In other words, as far as the press was concerned, good news in this case was no news.

Recently, however, the issue of recycling and the surpluses of the oil producers has reemerged as debt-servicing problems have occurred as external indebtedness has grown. A number of journalists and congressman too have voiced concern over the extent to which the private international banking system is committed to loans to the non-oil-producing less developed countries.

A careful reading of these reports suggests two separate lines of concern. The first is the claim that the large volume of foreign lending by U.S. banks resulted in the denial of credit borrowers in the U.S. and thus delayed the U.S. economic recovery. The second is the allegation that banks have made large numbers of unsound foreign loans with the expectation that the federal government will ultimately bail them out when foreign debtors run into payment difficulties.

On the first concern, the leading officers of Chase and other major New York banks will, I'm sure, find a certain amount of rather ironic amusement in the charge that they have denied credit to would-be U.S. borrowers. The fact is, with a 15% decline over two years in loans from major U.S. banks to commerce and industry, bank competition for business in recent months has been particularly fierce. Indeed, the search for domestic borrowers has become so thorough that your once-friendly banker has become downright compassionate. (Laughter) So the suggestion that foreign lending has led to the denial of credit to domestic borrowers and thereby held back our economic recovery is just flatly untrue. I believe all of you in this room, hopefully, all our customers, will attest to that fact.

The second concern that banks have dangerously overextended themselves to making foreign loans to chronic debtor countries, particularly the lesser-developed countries, requires – I must say – a somewhat more extended response. For the reality of the role of the private banking system in helping to finance LDC deficits is far more complex than the alarming headlines or the glib statements would have us believe.

Let me begin by stating unequivocally that Chase, and I suspect other major international banks, expect to be actively engaged in the business of prudent foreign lending for the foreseeable future. By and large, Chase's major lending emphasis is on short-term, commercial loans to finance trade and private business as well as project loans that are self-liquidating through the generation of exports.

New loans to governments for straight balance of payments purposes will still be taken up by banks, but I believe that lenders will be increasingly selective and cautious in adding such credits to their portfolios. Certainly that's our posture at Chase. If there's any serious question as to the ability of a loan to be adequately serviced, whether for balance of payments or other reasons, that loan is simply not extended.

In this regard, it's often forgotten that the largest proportion of overseas loans by American banks – about 70% of our total at Chase – is to industrial countries including the OPEC surplus nations. Moreover, among the LDCs, the greatest volume of credit has been extended to what the

World Bank has come to call, “high- or medium-income” nations – countries such as Mexico and Brazil. Comparatively little bank lending has flowed into so-called low-income countries such as India, Pakistan, and many African nations.

For example, there’s no denying the fact that bank loans to the wealthier LDCs as a group have expanded significantly since the oil price increase in the winter of 1973-74. All told, the exposure of U.S. and other foreign banks to these countries has risen from $39 billion to $77 billion in a little more than three years. But on the other hand, I think it must be recognized that the capacity to service debt has also been increasing albeit perhaps at a somewhat slower rate. Over the past three years, the exports of the LDCs have advanced by some 65% and I would say that this is not bad performance considering the state of the world economy.

The heart of the potential LDC debt problem is not an unwillingness or permanent inability to service contracted debt, but rather a temporary shortage of supply of the foreign exchange required to make external payments. The normal remedy of LDCs in trouble under these circumstances is not default, nor does it generally even mean debt moratorium. More usually, it involves a refunding or a rescheduling of that debt. Now obviously banks prefer not to reschedule, but even in cases where they must, such action neither impairs bank capital, nor does it decrease bank earnings. Again, this really critical point seems to me to have been largely overlooked in the current dialogue that we’re hearing today.

Clearly, some LDCs have performed better than others and each has to be judged on its own merits. It's true that bank debt to a number of these countries has been expanding at a rate that should not and indeed cannot be sustained. This does not necessarily mean that loans to these countries are at present excessive, nor that banks need bailing out. It does mean, however, that the rate of bank lending will need to slow down, and that public policies must be directed to correcting the problems that give rise to such lending, most particularly the persistent deficits in the balance of payments of many nations, both industrial and less developed. It's on these public policies, in my judgment, that the attention of the press and the Congress should now be focused.

Unfortunately, many countries in the world, both those in deficit and those in surplus, have not yet undertaken tough adjustments that are required in order to bring about their structure of international payments, to bring their structure of international payments into better balance.

As I mentioned earlier, the deficit countries – particularly the LDCs, but also, I must say, some industrialized nations – need to expand their exports. They can do this only as the economies of the principal industrial nations grow and prosper. And clearly, Germany, Japan, and the United States occupy center stage in this particular respect, and thus far they have not accepted the full role that they must play. Germany and Japan have failed to provide stimulus for economic expansion or to show a willingness to incur deficits in their own current accounts. The U.S., on the other hand, has failed miserably to fashion an adequate energy policy – one that will curb its appetite for oil imports thereby helping to cut down on the OPEC surplus.

Meanwhile, many of the LDCs cannot escape taking difficult action to reduce their own deficits, even though this involves the painful process of slowing down on their economic growth. Inflation must be brought under better control, over-valued exchange rates must be eliminated, and a more positive policy adopted towards encouraging foreign private investment. Internally agricultural sectors need to be given greater encouragement, even at the expense of higher costs for the urban areas. Because it takes time for the effects of policy changes of this sort to be felt, even an LDC that boldly undertakes reforms is likely to need international financial support at least for a period of time.

So an adequate supply of public international credit – credit that could be conditioned on the adoption of government policies promoting efficient adjustment becomes a key prerequisite. This is particularly true now that bank lending will likely slow down.

While action to accomplish this could take a good many forms, one appropriate solution to the present deficiency in public credit might have some of the following four characteristics. First, enlargement of existing public credit lines or guarantees. And this may mean adding to the resources of international agencies such as the IMF and the World Bank. Second, increased public credit flows to each of the major classes of borrowing nations. Third, extension of these credits subject to rigorous conditions that assure domestic policies which promote efficient adjustment. And fourth, a substantial part of the funding should be obtained both directly and indirectly from the OPEC nations themselves.

Unfortunately, time doesn't permit me to examine these thoroughly, but I do present them here in their broadest outline. Suffice it to say that we cannot hope to solve these problems if our attention is diverted to scare stories and apocalyptic warnings. I assure you that banks like mine have a clear understanding of their role with respect to foreign lending. And we also understand our obligation to interpret clearly this role to the public. By the same token, your responsibility, as concerned businessmen and businesswomen, is to speak out loudly and lucidly for your own companies and industries and to challenge the media to report on your activities in a fair-minded, accurate, and comprehensive manner. I believe that our free press in this country is uniquely capable of such accurate and substantive reporting. And it seems to me that it's this kind of reporting that will most genuinely serve the public interest in the days ahead. Thank you.
(Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN JAMES W. DAVANT: Thank you Mr. Rockefeller. Now for the question period. Mr. McKinney will ask the first question, and then he will alternate with Mr. Debs in asking questions. Mr. McKinney.

GEORGE W. MCKINNEY, JR.: I have four questions that really relate to the same subject matter. But before we get into the questions, I'd like to point out that the extent of the collaboration that Alan Greenspan and I had on these questions was he furnished me with a copy of his speech. He doesn't have the foggiest idea of what questions I'm going to ask him. The first one is one that I think is uppermost in the minds of the business community and it relates to capital investment. Last year the share of the nation's output that was invested in fixed plant and equipment was the smallest in about 12 years. Alan, why is capital spending lagging today?

ALAN GREENSPAN: I think the answer is very simple. The solution is not. From what we can gather, there has been in the last four or five years, maybe more, a significant increase in the risk premiums that the business community is imposing on its expected future earnings from a new facility. And this increasing uncertainty has in effect required an increase – depending on what type of project – of one, two, three percentage points in the required rate of return in order to initiate a project. As a consequence of this, the higher required rates of return have reduced the potential profitable investments and I think account for the very substantial amount of the shortfall that we're now seeing. One other symptom of the same phenomenon is that there are clear evidences that the average life of the type of plant and equipment project which is being initiated is relatively short compared to what history was. Meaning in a sense that you don't get the 30-year long-term investments that we used to which is another way of saying that any profitable return expected in the 25th or the 28th year of an investment is so heavily discounted by these risk premiums as to have sort of negligible value. So that what the problem is an issue of confidence which is partly a reflection of inflation. What the solution is, is perhaps the most important domestic policy problem for the Carter administration.

GEORGE W. MCKINLEY, JR.: Another aspect of the same question, the replacement cost of net assets of non-financial corporations last year was about one-fifth more than their current market value. What impact is this having on capital investment plans of business?

ALAN GREENSPAN: Well, I think you're quoting from a paper...

GEORGE W. MCKINLEY, JR.: I'm quoting from a paper which you wrote...

ALAN GREENSPAN: Yes, I'm not going to deny the fact. (Laughter) That is another indication of the same phenomenon. I might also point out, however, that it's a little bit misleading to talk in terms of replacement cost of existing equipment. The one thing you're sure of, George, is if anyone had a chance to replace what they got now, they would do it with something else. So you can't exactly use that, but it's the closest we've got to measuring what is in fact the market evaluating in terms of plant and equipment that exists in place. And what those figures seem to be saying and almost are, in fact, saying is that if you spend a buck today to build a plant, you can be sure you can sell it for $.80 tomorrow when it's finished.

GEORGE W. MCKINLEY, JR.: Okay, a third part of the same question. The Congress has said it wants to stimulate business investment. You said that this is the only segment of the economy that really requires stimulus. And the Congress seems likely to pass toward this end an incremental employment tax credit that will give employers up to $40,000 of tax credits that will go toward paying the salaries of new employees. What impact do you expect this, and other stimulative measures that may be taken, will have on capital investment outlays for business this year and next?

ALAN GREENSPAN: None.

GEORGE W. MCKINLEY, JR.: Okay. (Applause) One final part of this question, under the circumstances that you have explained here, what are your recommendations to these people who are here tonight, businessmen in their own right, what are your own recommendations to them as to the capital investment policies that they should follow today?

ALAN GREENSPAN: I was doing fine for a while. Before I went to Washington, I used to think I knew all about these things. Having been there, I know there are certain questions which you duck, and that happens to be one of them. (Laughter)

RICHARD DEBS: Mr. Rockefeller, our dear, compassionate banker. (Laughter) First of all, on behalf of all of us borrowers here, I'd like thank you for a very provocative and really valuable statement – in many ways, a very brave statement. It gives all of us a lot to think about, particularly our colleagues in the media. Now I'd like to be provocative too. In fact, it's my job to be and I hope I will be. But before I am, I have a confession to make, and that is that over the last couple of years, both as a federal regulator and as a member of the private sector involved in international banking, I've thought quite a bit about these issues you raise. And my confession is this, that I agree with you. (Laughter) But I can't just stand here and agree with you so I will try the other side. And indeed, there is another side. And that is the response, I think, of the media and I certainly have heard the response, both with respect to the problem bank question and the LDC question, is this. That when it comes to banking, there is a good deal of secrecy involved, or what's called secrecy. There's relatively very little information available to the public. The public has expressed a good deal of interest in banks and banking and what they're doing, what their exposure is, and how the public itself is protected. There have been developments over the past couple of years since January of '76 when these stories first broke whereby I think it's clear to say that both banks and the bank regulators have embarked on a course of disclosing much more information than ever was the case before. And I'd like to ask you how you view this, how you view this trend, whether it has gone far enough or whether it's gone too far? You threw the challenge to the media to attain higher standards of excellence in journalism. I'd like to ask you how can help them to achieve this? What way do you see out of this problem? What is the proper balance between disclosure and the need, the recognized public policy need for confidentiality? How far are the banks willing to go? How far should they go? How far should the regulators go? And how can we face this problem? Indeed, all of us here representing the banking and business community, what can we do to improve our relations with the press?

DAVID ROCKEFELLER: Dick, I think that you posed a good question, a very good question in raising the question as to how far banks should disclose information about their financial condition and their activities. And I think that the answer to that is that it's a healthy trend that banks have, in fact, in recent years been disclosing an increasingly large amount of information. Just take the case of our own annual report. Only a few years ago we had about four or five pages of financial statistics that were included in our annual report. This year, as I recall, it is something like 45 or more pages of very detailed financial statements. How many people among you here read those is another question. But there are people among the financial analysts and maybe even some among the media who do, and I think that's good. And I think that it is desirable to have more information revealed than was revealed in the past. On the other hand, bankers – as doctors and lawyers – have special relationships with their clients and I think it's very important that some types of information not be revealed. It's obvious that this kind of information must be revealed to the regulatory supervisory authorities, and it is. What I find distressing is the fact that in the recent so-called revelations of the problem banks, information was somehow obtained, and I should say that it is a criminal offense for any individual in one of these regulatory agencies to reveal information voluntarily that is confidential. But that has not interfered with the fact that this information has been brought out and I think this is bad. It seems to me that there should be agreement as to what properly can be brought out and that should be, but that there is still a significant area where – for reasons of customer protection or in some cases for reason of not revealing industrial and competitive facts – this should not be revealed. And I still think that there is a significant area that, in my judgment, never should be made available to the public and is not necessary for the analysts and the public to understand the financial position of the banks.

GEORGE W. MCKINNEY, JR.: Alan, I've got another series of questions for you. This one's only three, so we're going downhill. The first of the three, you have described inflation as a financial phenomenon to be cured by reducing the size of the federal deficit and slowing the growth of the money supply. In the past couple of months, money supply growth has been very sluggish. M1today is actually below where it was two months ago. Real money supply growth has been negative for a period of years now. M2 is practically where it was two months ago. The question, how do you characterize the effectiveness and appropriateness of Federal Reserve policy so far in 1977?

ALAN GREENSPAN: Well, I'll go back to 1975. I think Chairman Burns and his colleagues have been extraordinarily successful in maintaining a policy which created a gradual significant disinflation from the end of '74 to the end of '76 and I think that they were major instruments in achieving that end. I think that the Fed was to be particularly, I think, given much greater recognition for its fairly gutsy attitude about not expanding the money supply in an excessive way in 1975 against the virtual unanimous advice of colleagues of both yourself and myself. The Fed turned out to be right. The economists turned out to be wrong in that respect. And I think that their policies since 1976 have also, I think, been quite commendable. I would be hard-pressed at this stage to find fault with many of the actions that they've taken.

GEORGE W. MCKINLEY, JR.: Might I point out that Alan said colleagues of ours; I don't think he said him, and I know damn well he didn't say me. I concur in your answer. The last time that we had a fiscal stimulus program that was identified as such was back in 1975. M1 growth jumped to double digit rates. The Fed stepped on the brakes. Short-term interest rates rose within three weeks more than a percentage point. Now we have another stimulus package coming up. Two parts to this question. One, what will the Fed do this time? Two, what should it do? And how do they differ?

ALAN GREENSPAN: I will really repeat what the chairman has said on such an issue. When you have a large one-shot rebate, as you well know, George, what happens is you bloat the money supply merely by the arithmetic of the Treasury writing checks to everybody who doesn't clear immediately. It is a tricky problem to deal with. It's not the exactly ideal situation for a central bank to function with. I think that what you will see is that the problem we had in '75 did cause the difficulties you maintain. It did not, I might add, put a crimp in the recovery which was very substantial at the time, going in a certain sense at an almost too rapid pace. There are a number of technical problems which arose at that time which I suspect will not at this stage. Exactly what the Fed would do? If I knew, I wouldn't say. And since I don't know, I don't even have to comment. (Laughter)

GEORGE W. MCKINLEY, JR.: Okay. Well, let's try another question. And again...no, this had three parts to it, Alan, don't go away yet. Again from the point of view of these fellows sitting out here, they have a vested interest in coming here and each of them have plans, capital investment plans for their particular concern which may or may not be large. But they require a certain amount of borrowing and they're wondering about the timing of that borrowing as with regards to maturities. What borrowing strategies would you recommend that they follow today?

ALAN GREENSPAN: Well, the implication of what I said previously is that the rate of inflation which has been unwinding for virtually two years, I would say at this stage has come to an end. The most significant element in the long-term interest rate is the so-called inflation premium in the long end of the bond market. That plus the extraordinary weakness in commercial bank loans pretty much fully accounts for the decline in long-term rates we've seen. I'll let David Rockefeller, if you want to ask him a question, answer the second part, but I'll answer the first part. I think the decline in the rate of inflation and its impact upon expectations as they embody themselves in interest rates is no longer going to push rates down. If anything, we're now moving in the other direction. When I'm faced with that sort of situation, I know what to do and I'm sure everyone else out here knows too.

RICHARD DEBS: I really stepped on it that time, but since half of Mr. Rockefeller's comments were directed toward domestic banking, maybe you would like to answer Alan's lag question.

DAVID ROCKEFELLER: I think what he's saying is that as demand for loans to the banks goes up, interest rates will too. We're hoping that will happen soon. (Laughter and Applause)

RICHARD DEBS: David, you implied that the banking system may have had the flu, but not an incurable disease. We've seen some stories coming out lately again on the question of problem banks and problem bank lists and so forth. What's your present diagnosis of the health of the patient? And how do you see it, and how do you see it in terms of loan demand, earnings of banks, loan losses and so forth?

DAVID ROCKEFELLER: Well, my feeling is that the banking system at the present time is basically very healthy indeed. And as I have suggested in my paper, it seems to me that considering the fact that we've just gone through the most severe recession since the Great Depression of the 1930s that it's a pretty good testimonial to the banking system that there have been so relatively few bank failures, so relatively little damage to the banking system. It's true that there are still problems which linger. Certainly the real estate industry, which had had almost 30 years of uninterrupted expansion, underwent a very severe recession. And I think it's going to take a few years more before that particular industry is fully out of the problems that it's had, and the banks are related to that problem. But on the whole, I think the banks are in a very strong position. Now it's true, what people are saying at the moment is that they've got a new threat, namely their loans to the less developed countries. And what I was trying to say in my talk was that although I think that this is a real problem, that the servicing of rapidly expanding debt is creating some problems in some countries, I think that by recognizing that now and by the banks on the one hand gradually curtailing the rate of their expansion of those loans and government stepping in and doing what I think they should, and most particularly the countries involved taking the steps to adjust themselves to this problem of balance of payments deficit, that any serious consequences can be avoided. Therefore, I'm really not that concerned about the future of banks. On the contrary, I think they're in very good shape.

RICHARD DEBS: One of the areas for where there certainly is this question of the LDC loans, and one of the solutions, I think, that you say in your remarks is the prospect of official aid. How do you gauge the prospects for that? And particularly, you mentioned the participation by the OPEC states. I know you've been out to the Middle East recently. How far do you see them stepping up to participation and obligation they have to come into this official lending?

DAVID ROCKEFELLER: Well, this is a rather unique situation in the sense that basically there are three of the OPEC nations which have been accumulating very large balances, namely Saudi Arabia, Kuwait, and the United Arab Emirates. And Saudi Arabia alone at the present time has surpluses of some $45 billion which is substantially greater than that of West Germany. They're accumulating those balances at the rate of $20 or more billion dollars a year and the other countries I mentioned are also accumulating. The question is what they're going to do with them, how they will invest them, how they will participate in the problem that you've just raised. To some extent, they have been participating indirectly already in the sense that a large part of their surplus has been placed with commercial banks in the United States, Europe, and Japan on, for the most part, a short-term basis. And those banks in turn have been using those funds to recycle the money to other nations, the developed nations and the developing nations. What I was suggesting is that I don't think that that can go on because I think the share of commercial, private commercial banks' obligations compared to government obligations to developing nations is getting too high. The percentage as well as the absolute amount of private bank debt held has been growing. And I think this can't go on very much more. Therefore, I think we have to see other kinds of participation including direct participation by those three nations. They've been hesitant to take this in the past. For one thing, when you look at a country like Saudi Arabia, it was only 40 years ago that it was basically a nomadic country with very, very low income, and with no involvement in international affairs. I think the fact that they've taken as constructive and knowledgeable and positive an attitude as they have is very much to their credit. But they have been slow in doing this, perhaps understandably. They are looking to place their funds with maximum liquidity, maximum security, and maximum return. Well, I guess all of us would like that. That seems like a sort of logical kind of thing to ask for. The question is how much farther they can go in that. I think the fact is they're not going to be able to resist more direct participation and I would be hopeful that there would be an increasing amount of it in the years ahead. And from my recent trip, I feel somewhat encouraged that this will happen.

CHAIRMAN JAMES W. DAVANT: Thank you Mr. Rockefeller. I'd like to again thank our two speakers, Mr. Greenspan and Mr. Rockefeller and also our two questioners, Mr. McKinney and Mr. Debs. I suppose, like most of you, I'm going to take Mr. Greenspan's advice and apply to

Mr. Rockefeller for a loan in the morning. To all of you, a most cordial evening. Thank you very much. The meeting is adjourned. (Applause)