The Economic Club of New York

The Honorable G. William Miller
Chairman, Board of Governors of the Federal Reserve

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Questioners: Norma Pace, Senior Vice President
American Paper Institute

Richard R. Shinn, President
Metropolitan Life Insurance Company

Introduction

Chairman Tim Dunleavy

Chairman Miller, members of the Economic Club, and invited guests, good evening. I'm Tim Dunleavy, chairman of the Club and your host for this evening. Tonight, we are honored to have as our guest speaker Mr. G. William Miller, Chairman of the Federal Reserve Board – a man who has served our economy both in the private sector and in the public sectors as well as the head of one of the very few central banks in the world that is independent of the government. (Laughter) They like that, Bill.

The question and answer period will be conducted by our two interlocutors. And tonight, a new precedent for the Economic Club of New York, our first interlocutor is Norma Pace, seated to my right, the Senior Vice President of the American Paper Institute. Norma, stand and take a bow. (Applause) Our second interlocutor is Richard R. Shinn, seated to my left, the President of the Metropolitan Life Insurance Company. Dick...(Applause)

Bill Miller came to the chairmanship of the Federal Reserve as only the second corporate executive ever to fill that post. The reaction to his appointment was something less than euphoric. In fact, the dollar slid to new lows against major foreign currencies. (Laughter) But those who knew of his record of continuing successes as Chief Executive of Textron recognized that he would bring new insight and forcefulness into his role as a central banker. And so he proved to be, to the world, by the strong belt-tightening actions that the Fed took last fall in support of the dollar which announced clearly that the United States was determined to win the war against inflation.

Mr. Miller was recently quoted in the Wall Street Journal as saying the duty of monetary policymakers is similar to taking away the punch just when the party is going good. Bill is no stranger to such difficult chores however. When he joined Textron in 1956 as an Assistant Secretary, he took up Chairman Roy Little's challenge that he be given a year to prove himself or be fired. A year later he was named Vice President and three years after that, President. In the ensuing years he won the respect of businessmen nationally and internationally. He is also well-known for having what one of his close associates called a steel trap memory.

An Oklahoman by birth and a Texan by upbringing, he enjoys describing the Wild West atmosphere of his boyhood years in the oil boon town of Borger, Texas, with its unpaved streets and its occasional gunfight. (Laughter) As a young man, he was drawn to the Coast Guard Academy, not by a love of the sea, but to get away from the gunfights. (Laughter) After gaining a bachelor's degree in Marine Engineering, he served in the Coast Guard until 1949 in the Far East and along the West Coast. While in Shanghai he met the lady who became his wife. That's called being shanghaied. (Laughter) Mr. Norch(?) gave me that line. (Laughter)

He went into law with the help of the GI bill earning a law degree from the University of

California at Berkeley in '52 and joining a New York law firm. There, in 1954, as an outside counselor, he came into contact with Textron and that special challenge from its chairman. Throughout his years in business, Bill Miller was frequently tapped for public service activities– as chairman of HIRE, the Labor Department's major effort to find jobs for Vietnam veterans, co-chairman of the U.S. -U.S.S.R Trade and Economic Council, and the Polish - U.S. Economic Council, and as a member of the Advisory Board of the Coalition of Northeastern Governors. In 1963, President Kennedy chose him as the first National Chairman of the newly formed Industry Advisory Council of the President's Committee on Equal Employment Opportunity.

At the time he was chosen to become a member of the Federal Reserve Board, he was a Director of the Federal Reserve Bank of Boston, a member of the Business Council and the Business Roundtable, and Chairman of the Conference Board and the Alliance of Businessmen. While Bill has gained success in at least four careers from Coast Guard officer and marine engineer to corporate lawyer and chief executive, and now public policymaker, he has set an increasingly fast pace which few men can match, leaving precious little time to pursue sailing, motor boating, or enjoying classical music, and an occasional evening at the opera.

His responsibilities at this time are awesome. Perhaps even more so to someone who as a young man witnessed the crumbling post-war economy of Shanghai. In the summer of 1946, where the inflation-ridden rate of price increases hit 2,000%, Treasury Secretary Mike Blumenthal also witnessed that summer in Shanghai, although he and Bill Miller never met until years later.

When Bill accepted our invitation to address the Economic Club tonight, obviously there was no need to create a topic since the economy is perhaps the most important topic on the minds of almost every American today. That's what prompted *New York Times* writer, Leonard Silk, to note – if you recall – in a recent column in which he theorized what New Year's resolutions top administration officials might make, that Bill Miller's New Year's resolution was to pray more in 1979. After seeing the story in the press yesterday, Ed Koch is probably also praying that the Fed will be able to create that 5,000 to 10,000 jobs for New York City.

It is my pleasure to introduce to you G. William Miller, Chairman of the Federal Reserve Board. Mr. Miller. (Applause)

The Honorable G. William Miller

Chairman of the Federal Reserve Board

Thank you very much Mr. Chairman, distinguished guests on the dais, and members and guests of the Economic Club. That was an interesting reminiscence of my history. I did enjoy my experience in Shanghai. Of course now, Chinese is coming up all roses. And in a few days we'll be seeing in the new Chinese New Year which is a great event – the greatest celebration the Chinese have. This year it's variously billed as the New Year of the Ram, but for many in Washington, it's sometimes characterized as the Year of the Goat.

I'm impressed with the attendance here tonight. I've heard of a two-tier market but I've never seen a three-tier dinner before (Laughter) and I had it explained to me. I realized that the meals come with a subscription, so I appreciate you're all hanging in there.

Last week, we had a very exciting event at the Federal Reserve Board, and this is really true. We have – I'm the fifth Chairman of the Federal Reserve, there have only been four prior. Strangely enough because of the austerity of the central bank, they've never had portraits. All the other buildings in Washington are filled with portraits of prior secretaries or directors or whatnot, but there have been no portraits of these chairmen. And so we had an unveiling and a hanging of these portraits. And honestly, one banker came up to me and said this is so exciting, we can hardly wait to see you hung. (Laughter) It really happened. I was taken aback. Well, thank you Mr. Chairman, for inviting me to be here this evening. I really do appreciate this opportunity to discuss some issues which are now really central to the welfare and progress of this nation. And indeed, I'm particularly pleased that this discussion could be with this audience, representing as it does the leadership that will determine the future of this country.

Well, in the past the subject of economics was notable for its obscurity – dull and dismal, remote from the interest of the average citizen. All that has changed. Today, economics is experiencing remarkable notoriety. Everyone is concerned about the cost of living, interest rates, the value of the dollar, productivity, and even the growth of the money supply.

The Federal Reserve, that unique title for a central bank or a monetary authority, is becoming better known than ever before. This is so much the better since it involves an overdue educational process of understanding the workings of our economy and its relation to our basic needs and objectives. It is so much the worse in that it comes about because of a dread disease – inflation – that threatens the health and vitality of our system. When I was nominated to be Chairman of the Federal Reserve a year ago, such was not the case. Inflation was a nagging problem, but it was not the principal enemy. All too soon inflation reemerged with surprising virulence and reasserted itself as a clear and present danger. Inflation quickly became our most important problem.

It is interesting that in our lifetimes we have never, in peacetime, suffered significant inflation in America, so all of us are going through a unique experience. We've come to learn that inflation destroys values and incomes. It dries up job-creating investments, impairs the prospects for new housing and other construction, and breeds recessions. It creates financial strains for individuals, businesses, and governments. It causes higher interest rates and disrupts international trade and the stability of the dollar. It is especially hard on the poor, the elderly, and those who live on fixed incomes. In short, inflation is the most disruptive force in our economy. It is the cruelest tax of all.

The international value of the dollar is also linked to inflation. The slump of the dollar on foreign exchange markets during the past year can be traced to the record U.S. trade and current account deficits and to the level and persistence of U.S. inflation. The decline of the dollar itself adds to inflationary pressures as the goods we import cost more and competitive constraints on domestic producers are reduced. The United States has a special responsibility to maintain a sound currency. The dollar is the predominant unit of exchange in international trade and international transactions. It is a principal reserve asset for the world's monetary system. The dollar, therefore, plays a key role in the health and progress of the world economy. And in our own self-interest, we need a sound dollar to avoid disruptions in our patterns of international trade as well as to damp inflationary pressures here at home. The program announced last November represented a forceful response to assure a stable dollar.

Inflationary forces within the U.S. economy have been building up over the past dozen years. The seeds of inflation were planted in the late 60s when large government deficits were maintained at a time of very high demand. When inflation persisted through the economic downturn of 1970, direct wage and price controls were imposed. They proved to be both inequitable and ineffective. With controls holding down the lid, the U.S. economy was stimulated, building up a head of steam in the kettle. Later, when the lid of wage and price controls was removed, the steam blew off in the form of explosive inflation.

During the same period, the fixed exchange rate system broke down. The entire industrial world experienced a simultaneous boon creating shortage in many industrial commodities. Agricultural reserves were exhausted through a combination of higher demand and poor harvest. Following the boycott, oil prices increased five-fold. The results of this sequence of events was double-digit inflation in the United States, for the first time in peacetime, and in many other countries. These shocks, as might be predicted, were followed by a recession around the world.

The recession was especially severe in the United States, but recovery has also been strong. The rate of inflation slowed somewhat in the United States as commodity prices tumbled. But looking back, the underlying rate of inflation declined only a little. It began to increase again as the recovery proceeded into 1968 with greater utilization of productive resources.

In the face of the re-surging and persistent inflation, the United States has moved progressively to mobilize a full arsenal of weapons to carry on a war against inflation. Let me outline briefly some of the components of that arsenal. First, fiscal policy. Second, incomes policy. Third, reduction in regulatory burden. Fourth, revitalization of productivity. Fifth, a balance in our international accounts. And sixth, a monetary policy which complements and supports the other elements.

In the case of fiscal policy, there has been a major shift toward tighter control over federal spending and a corresponding reduction of deficits. The original federal government financial plan for FY, for the fiscal year 1979 which began last October was modified after it was submitted to reduce spending and to cut back on proposed tax reductions so as to restrain the projected deficit by $22 billion. The administration and the Congress demonstrated their resolve to fight inflation by taking this unprecedented but highly commendable action. As a result, the federal deficit will drop from $49 billion in FY78 to $38 billion in FY79 and the president has just submitted his new budget which reduces the figure further to $29 billion for FY80 even though this will mean some cuts in current service levels.

The application of increased federal restraint must have a further goal and that is to reduce the relative role of government in the American economy. The emerging pattern means a steady reduction in the relative role of government expenditures from the present 22% of gross national product to the 20% range as soon as possible. Potentially this would release $60 -$70 billion to the private sector where the cumulative effect of individual decisions by people and by businesses will have more beneficial impact than the monolithic decisions of a central government.

A second weapon in the fight against inflation is an incomes policy. Last October 24, the President introduced a broad-based program calling for voluntary moderation in wage and price actions establishing specific standards for wages and prices and offering a series of incentives for compliance. There's no intention by anyone in the government to reintroduce mandatory controls because they did prove to be inequitable and ineffective. But there is a basis for seeking the cooperation of both management and labor to accept mutual restraint in their own self-interest as a contribution toward curbing inflation and thus enhancing the prospects for real gain in compensation and in profits.

As this program has developed, most of the leading corporations have pledged to comply. The recent settlement with the oil, chemical, and atomic workers was in compliance with the standards and represents a responsible and encouraging sign. With further private support from both management and labor, the president's program can help in bridging over the time until fundamental fiscal and monetary policy can break the cycle of inflation.

A third policy concerns the reduction in regulatory burdens which have added to costs and thus to prices without commensurate public benefits. Unwinding unnecessary regulatory burdens will take time and may require some redirection through legislation as well as administrative action. While the short-term effects of reducing inflation may be moderate from this action, it is critical in the long run to unleash the American enterprise system from unneeded and costly restraints on its flexibility, responsiveness, and creative capacities. The administration has indicated its commitment to this objective and it is vital to our long-term welfare.

The fourth component is directed towards revitalizing productivity. During the first 20 years after World War II, productivity gains in the United States were the highest in the world running about 3-1/3% per year. This helped counter inflationary pressures even while Americans were achieving annual increases in real income. But for the past ten years, we have fallen woefully behind and productivity gains have been running at less than 2% and even lower for the last five years.

One of the principal reasons for this is that the United States has seriously lagged behind other industrial nations in replenishing its capital stock. In Germany, 15% of gross national product is devoted to business fixed investment. In Japan, over 20%. In the United States, 8-10%. No wonder that we're falling behind in modernization, in technology, in productivity, in our capacity to compete in the world. The tax legislation passed by the last Congress included provisions to liberalize the investment tax credit and to promote capital formation. But much, much more will need to be done if we are to reestablish our position as the leading industrial nation of the world, and this business needs to be addressed urgently.

Fifth has been the marshaling of policies and resources to deal with the international situation. The decline of the dollar in foreign exchange markets over the past year is clearly linked to the U.S. inflation problem and to our current account deficit. And the decline of the dollar has, at the same time, been one of the causes of rising inflation in the United States as essential imports have cost more and competition of imports of domestically produced goods have been reduced.

One of the contributing factors to our trade deficit, and hence to our current account deficit, has been U.S. requirements for imported oil. The problem has its origins in history. For a long time, America was a vast, sparsely populated continent with seemingly inexhaustible supplies of inexpensive energy. A great industrial nation was built in part by taking advantage of cheap energy, sometimes in substitution for capital or labor. But in time, with ever increasing demand, the limitation of supplies became a reality. Now the United States must be engaged for a number of years in converting its industrial facilities, transportation equipment, housing stock, and commercial establishments to more energy efficient and more energy conservative methods of doing business. We also must convert to local supplies of energy.

Because the United States is a heterogeneous nation with many regional differences, as between energy producing and consuming areas, it has been particularly difficult to hammer out national energy policies. Important progress was made through the energy legislation enacted by the 95th Congress which deals, among other things, with conservation, conversion to coal, and natural gas. The new natural gas law creates a single national market where previously there were two markets – the higher priced intra-state market with a surplus and the regulated lower priced interstate market with short or uncertain supplies, particularly for industrial users.

The immediate consequence of the new law is that now there is abundant supplies nationally of natural gas which will immediately reduce the requirements for alternate imported oil and liquid natural gas. Now attention will need to be directed to bringing the market forces to play with respect to oil and directed toward looking at the alternatives for moving domestic oil prices to world levels, and thus incentivizing the development and production of more indigenous sources.

Mention has been made already of the factors that influenced the decline of the dollar over the past year. By late October, the lower exchange value of the dollar could not be explained by fundamental developments such as inflation or current account positions. In view of this circumstance and of the importance of the dollar as a world currency, the administration and the Federal Reserve, in cooperation with the governments and central banks of Germany, Switzerland, and Japan decided to act forcefully to correct the excessive depreciation of the dollar. The measures announced on November 1 included a substantial increase in foreign currency resources immediately available for U.S. intervention, expanded gold sales, and a further sharp tightening of U.S. monetary policy.

The monetary action included a 1% increase in the discount rate which was the largest increase since a similar move during the bank crisis in the early 1930s. Also it included an increase in the federal funds rate and a 2% increase in the reserve requirements on large certificates of deposit. The marshaling of foreign currency resources for intervention on the U.S. side, in addition to the direct intervention by other countries' central banks, involved an initial total of $30 billion in Deutsche Marks, Swiss francs, and Japanese yen mobilized through federal reserve swaps, U.S. Treasury drawings on the International Monetary Fund, and sale of special drawing rights, and a U.S. Treasury program for sale of foreign currency denominated obligations.

The sale of foreign currency obligations represented an historic step for the United States and opens a new opportunity for acquiring foreign currencies without expanding the money supplies of other nations. The first sales of DM and Swiss franc obligations have now been completed very successfully. The United States, and certainly the Federal Reserve, is firmly committed to its dollar support program, and we will play an active role in helping to achieve and maintain international monetary stability.

Finally, a word about monetary policy in this great war against inflation. Of course, monetary policy must play a key role. The Federal Reserve, therefore, has moved early and progressively to apply monetary restraint and reduce the growth of money and credit. The federal funds rate and short-term interest rates have risen more than three percentage points since the beginning of 1978. Consistent with normal lag effects, the growth rate of the monetary aggregates has slowed appreciably over the past few months. The Federal Reserve intends to continue working toward a gradual deceleration of monetary and credit expansion to a pace consistent with price stability. The task of monetary policy will be aided by the concurrent pursuit of tighter fiscal policy. We are determined to see that the inflation rate is pushed in the right direction down towards zero and that it is kept moving in that direction until we reach that level.

The short-term goal of all these policies has been to slow the rate of growth of the U.S. economy while maintaining a balance in economic conditions. The original target for 1978, for example, was about a 5% real growth rate. With the imposed restraint, the actual rate was brought down to about 4 1/4%. Monetary policy had several important objectives in bringing about this moderation. One was to apply restraint until we did dampen the rate of economic growth more consistent with our capacity and our available resources and to continue it, second, in that direction on a smooth path avoiding the dislocations and disruptions and shocks that have been too typical of this decade. And a third objective was to apply this restraint while maintaining balance in the economy and avoiding an undue burden on any one sector or any one group of citizens. And a fourth objective has been to accomplish this without triggering a recession.

The economy has been in remarkable balance and there is no current indication of significant overextension or underutilization. With continued monetary and fiscal discipline, the outlook for 1979 is for real growth of 2 - 3%. Unemployment may increase moderately and there may be a slower growth rate in the labor force, but inflation will begin to move down this year. Because of the balance in the economy and the absence of excesses, a recession is not indicated. Our objective will be to maintain slower growth for a considerable period of time working off inflation but avoiding disruptions of consequence either domestically or internationally. The slower growth rate in 1979, along with the higher growth rate in other leading industrial countries will also contribute toward a reduction in the U.S. current account deficit. The deficit for 1978 was about $17 billion. In 1979 it should be well below $10 billion with the prospects for balance in 1980.

Any great war runs the risk of undue hardship and suffering. In the war against inflation, we must take account not only of the condition and strength of our enemy – inflation – but we must think of policies which reflect a sensible humanity. We’ve, in the past, exercised policies which did cause very high amplitude swings in our economy thus bringing on considerable disruption, considerable uncertainty, and considerable hardship. An alternate strategy of a slower economic progress for a sustained period of time promises to have the best prospect for ringing out inflation without ringing in human hardship. But it also will test very completely our character, our capacity, our will, our determination.

Americans historically have favored quick solutions, instant answers, and because our nation is so strong, we've often been able to fulfill that expectation. But the quick responses represent here enormous risk and the question is will we, as a nation, see the inherent danger? And will we be willing to work together for a program of moderation for a long period of time and maintain our own individual and collective aspirations for enough years to correct the problem and return us to achieving the objectives of full employment, price stability, and a sound dollar which we must have.

Our nation is truly a strong nation. It's four decades ago that we suffered for a long period of time – in peacetime – the kind of uncertainty and distress that we have seen in this decade. In the 1930s we did have the agony of depression and we did have to struggle with trying to find our way back to economic progress. How many things have been developed since then that have cushioned the dangers and yet how many dangers still lurk?

The shocks that I've described in the 70s would have brought most economies of the world to their knees. The fact that our country has had the resilience and the capacity to absorb these and still have created as much increase in real incomes and real economic progress as it has is a great credit to a fantastically effective system. But that system is not endowed forever. It is up to each of us and all of us to determine whether we will now measure up to the test, the grueling test we face in the next few years. And that test involves new directions of economic policy and new directions in the role of the government in our economy.

One lesson we should have learned is that our system will work best and most efficiently if we rely more upon the private sector. One of the great strengths of our nation is the fact that we give more opportunity to private enterprise. And there are many reasons why we'll need to emphasize that and fight for it in the years ahead because in the last analysis if we don't recognize that and move in that direction, we shall not win the war against inflation. And unless we win the war, unless we maintain the efficiency of the private sector, the private enterprise system, then surely behind that comes a threat to our own personal liberties. Our nation cannot possibly meet the ambitions of every American citizen for basic freedoms unless it maintains the freedom for choice within its economy system. And there is what we must all be dedicated to do in the great fight against inflation. I believe we shall do it and I believe we shall prevail. Thank you.
(Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN TIM DUNLEAVY: Thank you Mr. Chairman. Let's set up this evening for the questions. We're going to, since Mr. Miller is going to stand here at the podium and answer them, we're going to ask our questioners to stand up each time they ask their question so that you can see them and hopefully hear them in the back of the auditorium. So who's ready to start? Norma, may I move the lady first?

NORMA PACE: All right, thank you. Well, Bill, listening to you I don't know why Senator Proxmire gave you an F. I would certainly give you an A. Most of all we're encouraged by the kind of program that you outlined to curb inflation, namely relying on many, many avenues, rather than just monetary policy alone. So my question starts out with a matter of monetary policy. Every time the money supply figures are published on Thursday or Friday, the market flutters and many, many analysts can predict with great certainty what the interest rate is going to be. But I ask you what is monetary policy given the dramatic changes we have had in money instruments and money management by both lenders and by borrowers? Has the Fed lost much of its grip on the economy through the development of these new instruments? For example, if you think about foreign sources of income and money supply that can come in through foreign sources, not only foreign banks but just private placements. That's an area that's out of your control.

THE HONORABLE G. WILLIAM MILLER: Well, Norma, monetary policy certainly is more difficult in a world that has become more interdependent in which the very creativity and innovation of our system seeks to adapt to constraints. That's one of the geniuses of a free system of course. That means that in almost every place where a regulatory or limiting policy or regulation impedes adjustment to the economic realities, people – including banks, including individuals – begin to invent ways to get around that limitation, to get at the real economic realities. You see that when we have a Reg Q ceiling on small savings, a legislated limitation on what can be paid for small savings. Well, it doesn't take those who have small savings very long; even though they usually are people of limited means, to realize they're being cheated in a world when interest rates don't, aren't consistent. It doesn't take them very long and it doesn't take people in this room very long to invent some way where those small savers can find another place to get a return on their money. And so you see money market funds and other kinds of small denomination, fixed income securities become available and information being what it is, it soon begins to move which shows both the strength of our system in adapting, but shows how much difficulty it puts on the monetary authority to be able to predict and deal with what has been historically thought to be the monetary control measures. This doesn't concern me because I think our task is to relook at the fundamentals and to make some reforms ourselves in the system to make it more responsive to the needs of people and more responsive to reasonable constraints on the aggregates rather than on the individual limitations. We, in the process, will do several things. We're going to look at redefining these aggregates. We have tended to define them historically – to the extent that that concept of kinds of money has come into being in the last 20 - 25 years – we have defined them by kind of deposit. And that isn't very logical so the Federal Reserve is about to go through a process which we hope you will all help in because we want everybody's ideas of redefining kinds of money by their function. And as we do that, we'll upset the Thursday night, you know, raffle, but we may get more sense and logic. And that's only one of the examples of the things we're going to have to do to adapt to the changing world and be responsive to the real practice.

RICHARD R. SHINN: For those of you who might at some time be asked to be a questioner, I have just two bits of advice for you. Try first to pick a night when our friend Bill is not on the program because he tends, as he makes his remarks, to very quickly deal with most of the questions you were going to ask. And secondly, a time when things don't change so rapidly because I was going to talk about interest rates and one of my questions, in coming up in the car, I learned that one of the banks cut the prime this afternoon. So this tends to make, this is a difficult time to ask questions.

THE HONORABLE G. WILLIAM MILLER: You know when I saw this large crowd, I really thought, Dick, originally I thought it was because they assumed this was interest forecast night. (Laughter and Applause)

RICHARD R. SHINN: I tried to find out at the cocktail party with no success. But, Bill, I think the question that I have follows somewhat on the ones that Norma asked. Namely that it was expected that the rise in the interest rates and the moderation in the increased money supply would sort of dampen down the demand for credit. Now there has been some easing recently and some moderation in the interest rates over the last couple of weeks. But the lending institutions with whom I visit and talk seem to feel that this is a temporary situation, that really the demand for at least the months ahead is likely to increase, and that therefore these two measures at least may not nearly be as effective as it was hoped for. Do you see an upward trend in the demand for credit? And do you think that if there is, this will be a temporary aberration and will correct itself over the longer period of time?

THE HONORABLE G. WILLIAM MILLER: Dick, I think the strength of the economy, the real strength of the economy apparently in the fourth quarter was quite more than we had been looking for. The rate of growth in the total year 1978 was perhaps more or less in line. It was an erratic year. We started off with zero growth in the first quarter – real terms – jumped up because of the push forward of activity and the pull forward of activity in anticipatory buying to 8.7% in the second quarter. It dropped to 2.6% in the third and then apparently we have 6.1% in the fourth. All that shows is that the economy is a little bit hard to predict in the short-term. And I would be very reluctant on the basis of initial time to assume that the demand for money and credit has permanently abated. I think we have to be very, very careful not to be too ready to take the restraint off the pistol until we see real evidence that we have accomplished our purpose.

NORMA PACE: Well, let me stay with that question a little bit. This recovery has been paced by heavy spending by consumers and housing activity. As you said yourself, the imbalances in the economy in terms of too much inventory or too much capacity don’t exist at the present time. If we were to pursue a continued policy of restraint, is it possible that we would hit that sector of the economy that we shouldn’t be hitting, namely business borrowing? Aren’t we counting on business borrowing and expanded business spending to carry us through this second phase of the recovery? And isn't there a danger that we're going to prevent that from happening?

THE HONORABLE G. WILLIAM MILLER: The best mix in economic progress in the coming quarter would be to see a dampening, a moderation in personal consumption, a moderation in housing, and a continuation and expansion of business fixed investments because there is where we need the emphasis to gain the competitiveness and productivity that needs to be rebuilt. So that would be the ideal mix. I'm not sure that we can manage our economy so precisely because as we have gone forward in this expansion period, it's been amazing, partly because of low productivity, how many jobs have been created. Jobs, of course, generate more personal income and more spending so that demand feature is probably going to be relatively strong and we should be careful. Let me go back just a minute, Norma, and point out that there's perhaps a number of misunderstandings about the policies we've been trying to pursue, or questions, or concerns. One is, of course, that the introduction of the money market certificates for thrift institutions and banks last June have been looked upon both as a Godsend and a problem. It certainly was effective in attracting, initially attracting, substantial new funds and substantial amounts of new funds available for sustaining the housing industry and to that extent pull funds away from some other sectors. We did that because of this objective of trying to maintain balance in the economy and the results have been fairly favorable. In 1972, at the end of the year, housing starts were running at a rate of – it wasn't for the year, but that quarter – it was running at a rate of 2.5 million which is far too high. But with the run-up of interest rates and the move or the disintermediation, funds moving out of savings into market instruments, there was, regardless of interest rates, there was a complete drawing of the funds for housing. And housing went from 2.5 million rate within eight quarters – within two years – it was at 900,000 starts. That was not a recession, it was a depression. It did irreparable harm to the housing industry – many bankruptcies, a lot of unemployment, a lot of built-in cost when you inflate an industry and then collapse it and try to put it back together again. It's no wonder we had problems. We want to avoid that. And yet at the same time, we don't want to be unrealistic and keep money so available and credit so available that everything booms up to a level of creating a deceptive demand ___ place along with the cost ___. So we have a very delicate tread to go. And all I can say is that the shifting of the sectors in the direction we'd like them is going to be extremely difficult and it may be that you'll have to learn some new techniques. But our objective would be the same, and that is to maintain this moderation, preferably through macroeconomic action, and to avoid dislocations, disruptions in any sector that would lead us into a tailspin of a recession. One of the great dangers in this whole strategy is that a recession will unleash once again the policy of federal spending as a countermeasure. And the real important thing to accomplish this time is to maintain fiscal discipline. And if any adjustment has to be made in the economy to keep it within the bounds of progress, it should be done through monetary policy. And the real risk is that we'll get conditions where the fiscal spending, the federal spending will be opened up again and we'll head off again toward high federal deficit and a whole new cycle of federal spending-induced inflation that will start us back on the treadmill. (Applause) In the whole history of this republic we had accumulated $375 billion of debt before this decade, and in this decade we will have doubled that. And we can't live that way, and that's the lesson we've got to learn. (Applause)

RICHARD R. SHINN: Bill, in your remarks you mentioned the attention being given to the trade balance and we're optimistically forecasting that there will be a decline in the period ahead. If I read the various publications it seems that increasingly, notwithstanding a weak dollar and the strong currency around the world, our imports have continued to climb other than in the oil. Our exports have not, in fact, grown rapidly. A number of the products that we, for a long time, have had a major share of the world market, we've been losing share of the market. Is there emerging an export policy on the part of the administration that is going to deal with this issue?

THE HONORABLE G. WILLIAM MILLER: Dick, the export promotion efforts have been started, but in my view they are yet inadequate and need to be emphasized a great deal more. I didn't cover it in my prepared remarks, but looking at some of the more precise targets we might be seeking in our economic policy I did mention the importance of investment. And I would think we ought to move our investment levels up from 8 or 10% of GNP to 12 or 13% by deliberate motions. Our exports have been about 6 ½% of GNP and we ought to endeavor over five years to move that up to 10% to offset some of the demands that we have no other way of filling. And in my humble opinion, the world markets have the capacity to absorb that. That's not an unreasonable change in the pattern of world trade. All it takes on our part is a willingness to take away the restrictions we put on ourselves in speaking and to educate businesses of all sizes and all levels on the potential market and to get at the business. Now we're already making good progress as I mentioned. On the Census Basis, the trade deficit for 1978 was announced today or yesterday and it's about $29 billion. Remember in '73, we imported $8.5 million worth of petroleum and had a trade balance. Last year we imported $45 billion worth of oil and we had a $29 billion deficit. So that's the problem we've got to overcome. But it's highly probable in 1979 our deficit will be about $20 billion – a substantial improvement. We also have many service incomes and investment incomes that bring that down so that the current account deficit will be below $10 billion. So you can see it wouldn't take much effort if we put our minds to it to close that gap and that would do enormous good in strengthening the dollar and reestablishing confidence in the international monetary system. We ought to do it. (Applause)

NORMA PACE: I would like to return to some of the other components of inflation control – mainly the incomes policy that the president announced on October 24. It seems to me that we have built in a lot of rigidity in our wage structure. And with our productivity low, as you mentioned, the unit labor costs are rising rapidly and they are pacing prices. Now I don't understand how a policy of monetary restraint will change those rigidities. And most of us, even if we accept that the voluntary so-called price and wage standards will work, we know they'll only work temporarily. They'll simply be buying us time. What I'm saying is suppose a year from now you discover that the combined policy of wage restraint and moderating the rate of growth in the money supply does not change the rigidity in the wage structure, then where will we be?

THE HONORABLE G. WILLIAM MILLER: Norma, let me address some of the fundamentals you mentioned just in a broader sense for a moment. In the first place, you're absolutely correct. The process of inflation has brought a response of many components of the economy who have the bargaining power to protect themselves and that builds in a structural inflation. I would say that perhaps almost 50% of income recipients in the United States are now indexed – some through cost of living provisions, some who are in companies that have cost of living so that the effect of it is spread to other employees, salaried employees, some through government payments, whatever. And when you have 50% of your income recipients indexed, it gives to them the perception of being protected. But, of course, they're not protected because in the first place they never can win the fight against escalating inflation and destroying their real values and destroying the capacity for investment in job creation that will ultimately provide economic well-being. So it's a false, it's a false way to go, and yet very attractive. In fact, we have many businessmen who propose that we index the tax system to shelter them. Unfortunately if we shelter ourselves, then we destroy all the inflation fighters, and if we have no inflation fighters we'll have inflation. So it's a very attractive way but it's the wrong way to go. We've got to be courageous enough to say we all have to suffer from inflation so we'll all care enough to get rid of it, and we ought to do that. But in the meantime, we have a structural inflation built in, you know, annual increases in government salaries and so forth. Those things, I might add that there are legislative devices too, the minimum wage, the recent increases in payroll taxes which are necessary to fund certain benefits. But no one looked at the benefits; they only looked at escalating up the direct costs of them. And we must pay for them, but we also can look at whether we can afford them. As long as those things take place, then the responsiveness to the economy to reacting to economic downturn is much less. And that's why the old Phillips Curve doesn't work anymore. That's why the relationship between unemployment and inflation doesn't have that relationship. And that's why it would take a far deeper, longer recession to change those patterns and we could suffer. And that's why the alternate strategy of lower growth rate for a longer period of time is the only alternate strategy until you can unwind those systems of built-in inflationary bias. It's a painful process and, as I said, it will test our will, our determination. But it is the only logical course to follow if we are to convince people that their own self-interest requires them to dismantle the structure that is feeding on itself to destroy their value.

RICHARD R. SHINN: Bill, of late a great deal has been written about the so-called huge Euro dollar float and questions as to the implications that it did have on the international monetary system. It has been suggested that this is the large sums of money that are really under the control of no central banker. Do you regard this as a problem overall? And if so, are there any answers to it?

THE HONORABLE G. WILLIAM MILLER: Yes, I would view it as a problem of world liquidity that goes along with the problem of excessive world liquidity – alternate sources of money or credit which come into our own economy or which fuel overexpansion in the world to create the inflationary bias that we're trying to curtail. So in that sense we do have a problem.

These kinds of problems come about, of course, by our actions. We create these things ourselves. We created the Euro dollar market by imposing some controls or attempting to impose some controls on our own economy so that alternate solutions were developed that led to the development of the whole Euro dollar, Euro currency market. It is variably reported that Euro currency deposits run from $400-$600 billion. And when you look at our basic measure of money in this country as being about $360 billion, you can see that you have a lot more money in that particular market than we have in the M1 measure in this country. So it is a problem. It is part of the general problem of perhaps human nature where availability of readily spendable resources is attractive and no one notices that that liquidity does begin to impair the fundamental value. What we can do about it and how we can do about it, I think, is just premature. Disrupting those markets, once they've become essential to the working of the international system, must be treated with great delicacy. Again, I'm not one who believes that shock and throwing various sectors of our financial or economic system into a tailspin is necessarily the solution, but I think we're going to need some actions that will moderate that liquidity so that we do have some reasonable relation toward the overall objective. And I apologize for not being prepared to give you some specific suggestions now but I think it would be unwise to do so until we can find techniques that will treat it in a constructive way.

NORMA PACE: I'd like to deal with some of the structural changes, the legislative activities relating to the Federal Reserve now. Apparently Senator Proxmire has a desire to consolidate the three federal bank control agencies into a sort of federal bank commission. Representative Royce has, I guess, introduced a bill now to apply uniform reserve requirements to all institutions. And finally, the big question, the changing nature of competition in the financial markets has to be dealt with in terms of where can the banks find their future growth? What will be the growth pattern for the banks given the encroachment by other financial institutions on some of the normal banking activity?

THE HONORABLE G. WILLIAM MILLER: Norma, if I address those three subjects, we may be here 'til 11:00. I'm not sure everybody's ready for those. But let me give you a little hint. In the first place, the very process, as I mentioned, of our society moves toward innovation. And banks who originally had public franchises to accept deposits and deal in money and credit now increasingly find new forms of sources of money and credit that compete with them. And there's nothing wrong with competition, but as that competition evolves it must be equitable, it must be fair, it must not destroy the banking system or erode its capacity to serve this nation that is essential. And so as we see alternate forms of money and credit develop without control of the monetary authority, we have to become concerned and we have to try to rationalize the system not to inhibit innovation, but to assure that we have a sound and safe system and that we have equitable competition that serves the public with these franchises. Now I could go into infinite detail, but I'm not sure you can stand it. On the other two subjects, the universal reserve is part of the general problem we have in improving our monetary system. I mentioned the definition of monetary aggregates as part of it. We have to know what it is we're trying to control in order to control it. But increasingly, because of increasing competition from near-banks or other kinds of institutions, banks are increasingly finding it desirable to withdraw from the Federal Reserve because the cost of membership in maintaining reserve balances with the Federal Reserve is expensive in relation to withdrawing and competing without that burden with other new forms. And to the extent that deposits move outside of the Federal Reserve System, to that extent monetary control becomes more imprecise. If you look upon the monetary mechanism as being a lever and that the fulcrum is very, very imprecise and spread out and when you put pressure on one end, you don't know how it balances on the other end. And we need to come back to some more assured system of knowing that when we apply monetary action, that it will work in the movement of balances among accounts and among institutions in a predictable pattern. And it's for that reason that we must have some solution to this problem and we're working with the Congress and with the banking organizations and the thrift organizations. And they're all interested; they all recognize that we all have a problem because without a good monetary system, we're all at risk. The solutions, however, come to constituencies and constituencies have different views so it will be a very exciting year as we try to work this out. And some of the people on this platform, I hope, will vote right.

RICHARD R. SHINN: Bill, I'm told I have one more question. You've indicated that everyone in this country today more or less are amateur economists. They're following the economic news as never before, probably as much as they are the court pages. It's also been said that the expectation of inflation is as dangerous to an economy as inflation itself because it feeds inflation. Not too long ago, Tom Murphy was in this very room and was making some remarks about the economy. And something that he said at that luncheon seemed to have an imprint on the audience. He was indicating his concern that there's much discussion about a possible depression this year. And I think the word depression in the minds of the public may be quite different than the economists' definition of a depression. And the rather differing news that comes out as to what's ahead from time to time certainly must be creating some kind of a confusion on the part of the public as to how they're going to respond to these things. Certainly we're a society where ideas are freely exchanged and no one is talking about restraint. But do you feel that this prophecy of depression is having a negative impact – almost a death wish – and that it is a serious problem that one way or another should be addressed and try to get some understanding of what is meant by a slowdown in the economy as compared to a depression?

THE HONORABLE G. WILLIAM MILLER: Dick, I honestly think that the use of the word depression was nipped in the bud and I don't think it has become a factor in the psychology or expectation. It's so unthinkable that we would have a depression that I think that was a few-day wonder in the media and got substituted for banana(?) or whatever, and that took care of that. But I do think the expectation of inflation is a real problem. And I do think behavioral patterns are such that inflationary expectations determine spending patterns and that those themselves then create distortions in markets. Fortunately, we have not had the distortions we had in '73, '74 when there was not only hoarding and buying but there was literally duplicate and triple ordering in the industrial commodities because of fear that they would not be available. We've avoided some of that but we've had anticipatory buying now which worries us very much because that demand will not be there later when we need it to sustain our economy. And so it's terribly important that we convince ourselves and that through our leadership we convince Americans that we will win the war so that they will return to more normal behavioral patterns and help us move this down. We've got to do some structural changes. There's no doubt that looking at the issue we faced ten months ago or so, it was very hard for me personally to think of beating the drum about the danger of inflation when I knew that by itself would create this expectation and work against me. And yet if we didn't beat the drum about the danger of inflation I don't think we would have turned around fiscal policy and other policies. So we have those dilemmas, and as we all learn and understand the process better I think we can collectively do a better job in making that system work. And I know that the people in this room, through their leadership, can make a great contribution in that regard. Thank you very much. It's been a great pleasure. (Applause)

CHAIRMAN TIM DUNLEAVY: Bill, that was wonderful. No wonder you do such a good job down on the Hill in those question and answer periods. Well done. Gentlemen, we're going to give you a break tonight. We're going to finish up about 15 minutes ahead of time. Thank you very much for coming. Thanks to our interlocutors for their work tonight. And thank you, Chairman Miller, it was wonderful. (Applause)