THE WHITE HOUSE
WASHINGTON

May 1, 1975

TO: THE PRESIDENT

FROM: L. William Seidman

Good speech
GRF

THE PRESIDENT HAS SEEN ...

REMARKS OF L. WILLIAM SEIDMAN

NATIONAL ECONOMISTS CLUB

April 30, 1975
Washington-Hilton

Good afternoon, chairpersons and distinguished guests. I would like to review two subjects with you: Our current appraisal of the economy and our view of the threat presented by excessive Federal budget deficits.

While economic conditions remain a matter of great concern and some uncertainty, the outlook is stabilizing. We appear to have limited the risk that the recession would gain additional momentum and become even more serious. Identifying exact turning points is impossible as our diverse economy moves along, but there are increasing signs that the current recession should bottom out by late spring or summer. Real output gains should be reported later in the year, The pattern of recovery will vary widely among different industries and geographical regions, but a general economic recovery should be well underway before year end.

As the economy moves into the transition stage the economic statistics will comprise a mixed bag of good and bad news. Over the next few weeks, most of the reports will be bad. However, we must remember that these disappointing figures will refer to past events rather than current developments. As usual, we will only recognize the real turning points in retrospect -- and then only after several months of change.

Government policies are focused on aiding the sustainable economic recovery which now appears much more certain than the expectations of just a few weeks ago. In short, we are cautiously optimistic.

The basic factors that are giving confidence that the bottom of the valley is near are:

(1) Final demand in the economy, after declining late last year, stabilized in the first quarter. The preliminary estimates of retail sales for April suggest a further slight increase. They climbed 1.8 percent in real terms for the week ending April 12. The consumer has done his level best considering the way he has been treated by an inflationary economy.

(2) Inventory accumulation, which reached record levels during the last quarter of 1974, has been reversed and we are now witnessing record levels of inventory liquidation during the first quarter of 1975. This suggests the wisdom of the first economic law taught me by my father: "You can never tell what businessmen will do, but you can be reasonably certain that they will all do it at once."

(3) The inflation rate is down and inflationary expectations are not only dampened but thoroughly soaked in many areas.

(4) Plant and equipment forecasted spending, while down, is still likely to exceed last year in current dollars.

(5) Interest rates are down and funds are flowing into the savings and loan institutions. With money becoming available for

housing, we are now testing the confidence level of potential home buyers.

A restoration of consumer confidence is essential for recovery in the housing industry and in our economy generally. We believe that the loss of confidence has stabilized but that stabilization is at a low point. To confirm our general view of the present state of the economy and particularly of our view that consumer loss of confidence has stabilized, we see that the stock market is up with the Dow over 800 and the dollar is stronger abroad. With the tax cut taking effect in May, we can anticipate that this increased purchasing power will give an added quick stimulus at the right time to speed recovery.

Our worst problem will be unemployment -- rising numbers for another month or so. Lagging recovery in this most vital human area is a penalty of this recession. We know employment will be the last area to recover as it always has been. We are committed to do all we can to alleviate the human problems caused by our economic disruption.

In considering the <u>budget and our emphasis on holding down Federal deficits</u> there are two basic areas that need to be addressed. The first is the danger that deficits that are too large and continued for too long pose for future inflation. The second is the need to assure adequate investment and capital formation in the immediate future.

The threat of excessive Federal budget deficits can take several forms. Demands on credit markets by the Federal Government could tend to push up interest rates and reduce funds available for private investment, if responsible rates of monetary expansion are maintained. The effects on the economy would be felt first in sectors such as housing and investment in capital intensive industries.

On the other hand, if monetary expansion is increased to accommodate, at least in part, the additional demands on credit markets of huge Federal deficits, the higher rate of monetary expansion will eventually be reflected in higher inflation. In addition, the limits of productive capacity will be reached more quickly if private investment is reduced due to large Federal credit demands.

For these reasons, the Administration has emphasized the need to keep the Federal budget under control. Control of Federal spending has also been emphasized because additional Federal spending for public works projects usually has its main effect on the economy only after a long delay, with the main effect occurring after the recovery is well underway. Consequently, it can make only a limited contribution to higher employment during the recession.

Why the critical importance of assuring adequate investment or capital formation? The answer is jobs and an increasing standard of living.

The inflation we have experienced has had adverse effects on profits and on the capital structure of business firms. Inflation has distorted the meaning of conventionally reported profit figures. Profits from higher inventory prices make no lasting contribution to funds available for investment because the inventories need to be replaced at new and higher prices. Deductions for depreciation based on book values instead of on replacement costs have effects equivalent to an extra tax on capital when replacement costs are rising rapidly.

Finally, just as the buying power of consumers is eroded by inflation, the investing power of business is reduced by escalating prices for investment goods.

The effects of adjusting for these factors are quite dramatic. Reported profits of domestic nonfinancial corporations were up by about 45 percent before taxes from 1965 to 1973. When inventory profits and inflation are taken into account, real operating profits actually declined by 14 percent over that period. And adjusting in addition for historical cost depreciation converts the 45 percent rise in reported profits to a decline of almost 42 percent in real terms, after tax operating profits.

Increased investment funds are needed now so that roughly ten million new workers can enter the labor force by 1980. Jobs must be created for these people.

While the economy is presently operating well below capacity levels in most sectors, much of this slack would be removed by bringing the unemployment rate down in a cyclical recovery. Private investment is needed to avoid a premature end to the recovery and to provide jobs for the large number of workers entering the work force. Over $400 billion in investment between now and 1980 will be necessary to provide the number of jobs needed.

These heavy demands for investment and capital formation are accelerated by problems that have <u>been building over the past few years</u>. We have let our economic plant deteriorate. Increased concern for the <u>environment</u> and for health and safety in the workplace has led to legislation that significantly increases capital investment costs.

Most recently, the <u>energy</u> problem has created the need for major investments to develop our domestic energy resources and to restructure production to conserve energy. It has been estimated that more than $1 trillion will be needed during the period beginning in 1970 and ending in 1985 in oil development alone. And pipeline construction, coal resources development, and other energy projects to achieve the goal of Project Independence will add to this enormous figure.

<u>Electric utility</u> generating facilities are another area with huge financing needs in the immediate future. Construction of generating facilities has, in many cases, been cancelled or delayed as a result of difficulties in obtaining financing, or for other reasons. Financing needs

from external sources are particularly large now because electricity rates have not kept pace with massive increases in fuel costs. Electric utilities are also highly capital intensive. More than $300 billion worth of investment will be needed for electric utilities by 1985, according to the Project Independence blueprint.

A huge backlog of deferred maintenance, overly rigid and inefficient regulatory practices, and domestic transportation needs to achieve energy goals have highlighted the need for a massive infusion of investment in the railroad industry in the coming decade. The United States Railway Association has estimated that $7.3 billion of investment will be needed to rehabilitate and restructure railroads in the Northeast section of the country alone.

The financial plight and physical deterioration in the railroad industry demonstrates that we can no longer delay facing up to the problem of restoring a more efficient and viable transportation system and providing the capital investment that it requires.

I hope these illustrations help to indicate the underlying reasons for the emphasis that the Administration has placed on Federal spending restraint. The Administration's concerns arise not only out of concern about financial markets -- that is the area in which the symptoms of the problem would first become evident -- but because of the critical need to channel sufficient resources into private investment and capital formation in the next few years.

Failure to accommodate our private investment needs will limit the production and employment levels we can achieve, or reignite inflation, or both. The real issue is about real resources; will they be used for private capital or public consumption?

In summary, near term we can be cautiously optimistic. Longer term we must be vigilent to retain investment for the private sector by holding down the Federal deficit. For real jobs, we need more private capital, not larger Government deficit s.

THE WHITE HOUSE

WASHINGTON

May 2, 1975

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: BILL SEIDMAN

FROM: JERRY H. JONES

The President has read your remarks to the National Economists Club on April 30 and made the following notation:

-- Good speech.

cc: Don Rumsfeld