Remarks of SENATOR ROBERT MORGAN
Illinois Bankers Association
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## INTRODUCTION

Thank you. I am especially glad to join you this morning to discuss some of the important questions confronting the 95th Congress -- questions which will have an important impact on the state of our economy, and upon the banking community and the individual American consumer.

## 1978 ECONOMIC OUTLOOK:

Everything I have read to date cautiously points to 1978 as a year of continued moderate growth in the American economy -- roughly more of the same as 1977 -- sluggish, but nevertheless steady recovery.

Unfortunately, "more of the same" also entails an enormous budget deficit,

persistent price inflation,

a stubborn unemployment rate,

heavy foreign energy dependence,

a $30 billion trade deficit,

and prospects for continued trouble for the dollar overseas.

Lest this all sound too bleak, I firmly believe we need to remind ourselves that despite all these very serious problems, we remain blessed with an economy that has allowed the American people to achieve a combination of the highest standard of living and the greatest degree of personal freedom the world has yet seen. America still remains a land of opportunity -- and the creativity of our people remains undiminished. That special American genius for innovative thinking is alive and well! I hope that special talent can be harnassed to bring about a more enlightened and creative relationship between government and the private sector -- one in which both public and private policymakers can learn to work together more effectively to preserve the vitality of the free enterprise system, while at the same time safeguarding the social and environmental interests which have received inadequate protection in the past.

SPECIFIC ISSUES:

A. Banking Committee Issues:

(i) Miller's Nomination:

With that perspective then, let me turn to some of the specific questions in which I believe we share a keen interest.

The first issue which the Banking Committee must confront is one which will have a considerable impact on the economy for years to come -- the fitness of the President's nominee to chair the Federal Reserve Board -- a job called by some the 2nd most powerful in Washington.

While I have not yet met Mr. Miller, everything I have read about him indicates he is an able, talented man. Certainly I think the words of Dr. Burns, that in selecting Mr. Miller, the President "chose wisely and well," must be accorded a very great deal of weight.

But equally certain is the fact that Mr. Miller has a very tough act to follow! I deeply respect Arthur Burns. I am proud to be able to count him a personal friend, as well as say that I have seen eye to eye with him on most economic matters. His has been a steady, conservative influence at the helm of monetary policy when that was precisely what the country needed.

Before deciding how to vote on Mr. Miller's confirmation, I want to explore his philosophical approach to economic questions. I also want to make just as certain as I can that he has ~~the~~ a personal commitment ~~and the old fashioned intestinal fortitude~~ to maintain the independence and integrity of Federal Reserve decision-making. We have learned in the past that what is in the immediate interest of any particular Administration may not necessarily be in the best long-term interests of the nation.

(ii) Other Banking Issues:

The Banking Committee will also deal with a number of other issues of considerable importance to the economy and to the banking community and the consumer.

Specifically, I anticipate ~~markup~~ action relatively early ~~in the session~~ to establish federal law on electronic funds transfers. The need for federal law in this new field is generally conceded, and I am concerned that the law be a helpful and constructive one. I hope that bankers -- as those most knowledgeable and most directly involved in this highly technological question -- will continue to WORK with ~~make their views known to those of~~ us in the Congress. It strikes me that this is a classic example of the Congress legislating in an area of which we have very little first-hand experience or knowledge. I, for one, do not want to be totally at the mercy of the Banking Committee staff in this complex area, so I urge you to continue to ~~make your views known~~ remain actively involved throughout the legislative process.

I believe we can also expect activity on N.O.W. accounts, on Truth-in-Lending Simplification, alternative mortgage instruments, amendments to the Fair Credit Reporting Act in which Chairman Proxmire has expressed a keen interest, as well as attempts by the Chairman to mobilize public support for increased and centralized regulation of banks. It's my opinion that there is little sentiment for increased regulation within the Committee. I, for one, am convinced that the banking industry is already one of the most highly regulated sectors of our economy -- with results that are increasingly detrimental to the public.

INCREASED GOVERNMENT REGULATION

Throughout our economy, we have witnessed a vast expansion of federal authority via the regulatory process. Over the past decade the nature as well as the scope of governmental regulation has changed. A certain shrillness has crept into our national political discourse when consumer issues are raised. We are frequently confronted with a false dichotomy between the so-called "public" and "private interests -- a false division which denies the difficulty of defining and furthering the broad public good in a complex and pluralistic society. It strikes me that a good many consumer groups as well as a number of federal regulators suffer from the simplistic notion that the way to protect the consumer is to punish business! Nothing could be further from the truth.

It seems to me that we have indeed reached a point where the costs of excessive regulation have become uneconomic. What is not fully appreciated is that those costs ultimately come to bear on the shoulders of the consumer.

I was struck by a recent editorial in the American Banker entitled, "A Profits-to-Paperwork Ratio." I had it printed in the Congressional Record because I thought it deserved wider readership. The editorial discussed a well-run bank with a high return on assets which reported a net income before taxes of $16 million, while its cost of paperwork to meet regulations was $1 million.

The editorial quite rightly concluded that "when well-run banks find that one-sixteenth of pre-tax income -- over 6% -- is absorbed in filling out reports, something needs to be done. This is just too much dedication of bank resources to one small segment of the industry's operations."

The sad result of such excessive paperwork and reporting requirements, as many of you may have personally experienced, is that some bankers are deciding to abandon functions that otherwise might serve the community because it is not worth it to follow up with necessary regulatory procedures.

I don't believe any banker seriously objects to legitimate regulatory requirements. Regulation is necessary and is in the interest of the banking community as well as the public. What bankers do have every right to object to, however, is the tangle of confused and sometimes conflicting regulations which require an ever growing investment of time, energy, and money with which to comply. As more and more detailed information is demanded -- requiring painstaking responses from bankers -- my suspicion grows that a good deal of such information simply ends up in some bureaucrat's file, unread, unused, and unremembered.

That has to change, and I'm glad that bankers are taking the lead through the American Bankers Association's "Operation Unravel." Operation Unravel is an attack on specific laws and regulations found to be particularly bothersome and of doubtful benefit to the banking public.

Operation Unravel suggests changes in specific provisions such as the section of the Fair Credit Billing Act requiring lengthy explanations of rights to be sent to consumers many times a year. Also targeted are sections of the Equal Credit Opportunity Act, ERISA, the Home Mortgage Disclosure Act, and a variety of regulations. In each case suggestions for positive changes are made.

If people become more aware of the direct and indirect costs to the consumer of too much government at all levels, then perhaps Operation Unravel will become a successful opening shot in an effort to scale down the growth of government regulation, and to arrive at a means of achieving desireable social ends with less cost to business, and ultimately less cost to the consumer.

DEFICIT SPENDING

But battles against the entrenched conventional policy direction are always difficult. Let's examine the trend toward larger federal spending for example.

I believe it is imperative to bring federal expenditures more in line with revenues if we are to achieve again a stable healthy economy. It seems to be one of the great myths of our time that a nation can spend greatly beyond its means for an indefinite period of time.

Yet it is my understanding that our nation's seemingly hopeless addiction to large budget deficits is a relatively recent development, dating in earnest only from the days of the Great Society and the Vietnam war, with the exception, of course, of the massive debt accumulated in financing World War II.

In 1940 our national debt stood at only $43 billion. By 1946, unavoidable wartime borrowing had forced the debt to about $270 billion.

By 1966 it had grown to $330 billion -- a $60 billion increase over two decades -- twenty years of relatively steady, sustainable, non-inflationary growth and employment.

Yet since 1966, the debt has soared to $787 billion -- over twice what it was merely eleven years ago! Those eleven years have been a time of a stop-and-go economy which today experiences --

-- an historically unprecedented wage-price spiral,

a persistent 6% inflation rate which shows no signs of yielding, and which has cut the purchasing power of the dollar in half over the last 12 years, and will do so again by 1990.

--This combined with unemployment levels so high among black young people that Arthur Okun, Lyndon Johnson's Council of Economic Advisors Chairman, warns we are in the process of creating a new social and economic sub-culture.

Since I am not an economist, I can't draw any scientific conclusions from all this, nor can I offer any definitive policy recommendations.

But I do believe very strongly that these developments ought to cause us to question very seriously our seeming fascination with a Keynesian approach to spending. We have had very little practical experience with Keynesian prescriptions, and the experience we have had is less than comforting.

This general philosophy leads me to view with skepticism reports that the President will propose a tax cut in the range of $20-30 billion. As always the concept is to stimulate the economy by freeing more money for consumer spending.

But at some point I believe we must also make some very tough decisions about government spending. Tax cuts without concurrent budget cuts are an increasingly hazardous approach to fiscal policy.

TAX REFORM ACT OF 1976 (Note to Senator; You have not made a decision on this policy matter--Consider first.)

I know you have a special interest in the carryover basis and farm valuation section of the Tax Reform Act of 1976.

That law established carryover basis rules for determining capital gains taxes paid by heirs who sell inherited property. But it is my understanding that these rules are an administrative nightmare -- extremely complex and difficult to apply, as well as creating special valuation for farms and closely held business property.

Proposals to repeal or delay the effective date of the carryover basis provision of the Act are presently before the Senate Finance Committee and should come before the full Senate shortly. I feel that the complexity of this provision, and its possible adverse implications for family-owned farms and businesses merits a two-year delay in implementation, and very possible outright repeal.

This is another area where you are in a position to give those of us in the Congress very helpful guidance based on your experience working with those who will be directly affected by this law.

OTHER ISSUES: WELFARE, ENERGY, TRADE

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I want also to discuss some other issues with/you are probably less directly involved but in which I hope you share my interest and concern.

SOCIAL SECURITY/WELFARE

As with our penchant for deficit spending, I am similarly skeptical of some of the premises underlying some recent social legislation. There, too, I believe we may have embarked on a potentially risky course.

President Carter had advocated sweeping welfare reform, hospital cost containment legislation, and has committed himself to introduction of a national health insurance proposal.

In doing so the President has expressed important goals with which I substantially agree. The current welfare system is anti-work and anti-family, and this must be rectified.

Hospital costs have risen at twice the rate of inflation and must be brought under control.

And though we enjoy top quality medical care in this country, many Americans experience great difficulty in obtaining care, especially the elderly, the poor, and those in many rural and inner city areas.

These are difficult problems, and their solution requires action at the federal level, but also by state and local governments and by the private sector.

My concern is that the Administration appears to consistently oversimplify, and through the use of unrealistically optimistic assumptions, to understate the magnitude of the problems we face.

This oversimplification and understatement may have some short-term benefits, by making it easier to build up a concensus for a given course of legislative action, but it seems to me a sure recipe for long-term failure.

Let me give you an example of what I mean. The Social Security tax bill recently passed assumes that inflation will decline to four percent annually and that unemployment will decline to five percent by 1983. I would very much like to see that happen, but somehow those assumptions seem overly rosy to me.

Similarly, the Administration's welfare reform proposal assumes a return to full employment in several years which will allow a phase-out of the jobs portion of the reform package.

Since several Administrations, the Congress, and the private sector have labored without notable success for some time to solve our unemployment problems, it seems unwise to base broad social legislation which carries with it a hefty price tag on the premise that these problems will be resolved within the next several years.

ENERGY

President Carter's energy proposal, and various alternate plans which Congress is currently considering, will also have a major impact on money management, circulation and accumulation, regardless which side we take in the present energy debate.

Opponents of the President's plan talk about the largest peacetime tax increase in the nation's history, some $300 billion dollars over the next five years. This view of the Carter plan is misleading and misses two major points.

First, most of the taxes will never be collected. The point of the President's plan is to make our energy-wasting activities more expensive, to dissuade us from our wasteful ways.

Take the gas-guzzler tax for example. If the punitive tax on gas-guzzlers works at all, the tax won't be collected and people will buy more fuel efficient cars.

With an effective tax incentive to buy fuel efficient cars, Detroit -- which has ample room to improve efficiency in automobiles -- will make improvements that will both save energy and slow down real inflation.

Secondly, Carter's plan has been criticized on the grounds that it does not give the big energy firms adequate capital to explore and develop more energy.

The private market place as a whole will have as much money for capital investment as it can attract from citizens in the capital markets. Certainly, if the need for capital for worthwhile ventures is as great as the oil companies say it is, those same oil companies should have no trouble finding people willing to invest in new schemes.

Rather than going automatically into the hands of firms dedicated to capital-intensive energy development, the money from tax rebates goes into the hands of consumers who, I believe, will be the best judge of whether capital intensive energy development will be best for meeting their energy needs.

SOLUTION NOT JUST WITH GOVERNMENT

One of the most unfortunate results of the continuing focus on federal energy legislation has been the illusion that the solution to the energy crisis rests with the federal government.

If the private sector fails to respond in innovative ways, then there will be more pressure for the government to intervene. Private inaction will lead to more government action, leading to more private inaction. This cycle must be broken if a vigorous and vital system of free enterprise is to survive in America.

Credit organizations have an important responsibility in this process. Massive capital-intensive, centralized energy projects may be necessary, but the credit community must develop the enormous market for de-centralized solar, wind, and conservation systems.

Let me give you a couple quick examples. The expense of a solar home heating system is all in the installation. Once installed, "fuel costs," -- free sunshine -- are non-existent. But in deciding to switch from conventional sources of energy to solar heat, the consumer requires an incentive to accept the large initial cost of installation, and credit must be made available to allow the consumer to spread out these initial costs.

Insulating multi-unit or rented dwellings presents a similar challange. Insulation more than pays for itself over a few years, but often neither neither a tenant nor a property owner who doesn't pay fuel bills has the incentive to act. This is where imaginative credit schemes could save both money for the consumer and scarce energy for the nation.

INTERNATIONAL TRADE

Finally, I would like to comment briefly on the international implications of some of our economic difficulties.

The reality of an increasingly interdependent world links us ever more closely to other nations, and those nations are in turn increasingly dependent upon our own economic health.

Yet more nations are considering various forms of economic protectionism, and here at home protectionist pressures appear to be growing.

THE DOLLAR ABROAD

Let us consider the declining value of the dollar abroad. Some people insist that it is useful for our economy to allow the dollar to decline against other major trading currencies because it boosts our exports and attracts foreign investment, thereby boosting employment at home and hastening general economic recovery.

But just the opposite has been true! Instread of increasing exports, the United States experienced a 1977 trade deficit of more than $25 billion, quadruple what it was in 1976. This alarmingly large deficit weakened the dollar further.

It contributed to international monetary uncertainties, undermined confidence in the American economy, alarmed the stock market, dampened foreign investment, and generally added to inflationary pressures.

One major reason for our deficit, of course, is our heavy foreign energy dependence, which cost us about $45 billion in 1977. Thus, we need, as I said before, an energy policy that insures conservation while not adding to inflation.

Yet we must also strengthen the dollar since most oil contracts are negotiated in dollars. If the purchasing power of our currency declines, oil-producing states will seek to offset their losses through an increase in the price of oil. Thus consistent support for a strong dollar is of tremendous importance.

GROWING PROTECTIONIST PRESSURES

In the United States, excess capacity, persistent unemployment and a huge trade deficit have inevitably generated strong demands for tighter import restrictions.

Yielding to such demands elevates domestic political considerations over the general national interest in healthy and vigorous trade and threatens potentially serious consequences for an economically interdependent world.

A few weeks ago, I visited Japan for talks with Prime Minister Fukuda, trade negotiator Ushiba, and other officials. Serious economic problems beset our two countries.

Japan accumulated a $10 billion trade surplus with the U.S. in 1977. Consequently we are demanding that more American imports be permitted into Japan, that Japanese tariffs be cut,that various non-tariff barriers be removed, and that an import credit system be established.

Little progress had been made by the end of 1977 through bilateral negotiations, thus increasing voices in this country for partial protecionist policies.

But I question the wisdom of this policy course. From the Japanese point of view, their government agreed several years ago to increase imports of American soy beans. We then suddenly cut back on exports and left our friends in a predicament.

When the Japanese agreed to some American beef, the meat shortage came along, drastically increasing the price, and in the process taking ourselves out of the Japanese market.

Had we imposed an import duty on Japanese color televisions, the American consumer would have had to pay on the order of $35 more per set.

Restrictions of Japanese imports inevitably lead to corresponding cuts in our American exports. It seems to me we can ill afford to forget that:

<u>one of of every six manufacturing jobs in our country produces for the export market,</u>

<u>one out of every three acres of American farm land produces for the export market,</u>

<u>and almost one out of every three dollars of U.S. corporate profits now derive from international activities.</u>

The inescapable conclusion I draw is that <u>we need not</u> outdated and risky protectionism, but orderly market agreements to insure that international trade is competitive and fair, and to secure a healthy and mutually beneficial trading environment.

## CONCLUSION

These, then, are some of the issues with which the Congress will grapple in the year ahead. They are issues in which we need your active input.

We must re-think and re-examine our notions about government and society. The world is too complex for the simplicities of both the right and left-wingers. We need to strive toward a creative and pragmatic new relationship between the public and private sectors -- one which protects the general interest, while leaving the private sector free to do what it has always done best -- the creation of new opportunities in which the American dream and the ideals of a free society can be realized by an ever growing part of our population.