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ECONOMIC GROWTH WITHOUT INFLATION

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ECONOMIC GROWTH WITHOUT INFLATION

Unemployment, price stability and economic growth have become subjects of popular debate. It is asserted by some that a stable dollar and enough economic growth to provide an acceptable level of employment are incompatible. It is my own conviction, however, that price stability is necessary for high employment to be sustained. Perhaps our most urgent domestic necessity is to protect the purchasing power of the dollar while providing widespread employment opportunities. Both for the protection of those who live on fixed incomes, like pensioners and school teachers, and for the benefit of those who need steady work to support themselves and their families, we must—as indeed we can—achieve high employment without inflation.

Inflation is not an effective long-run means of creating job opportunities. But on this point thinking is confused. A recent letter asked "How can industry expand, buy machine tools and provide jobs for us millions of unemployed when you guys create tight money? - - - Haven't any of you men got the guts to stand up for an expanding money supply and abundance of credit to encourage production and help make jobs?" A blunt answer to this heart-felt query is that the mere running of the printing presses or its modern equivalent, the ballooning of bank credit, does not foster productivity improvement and higher standards of living. In other countries and even in our country, highly trained ability has been diverted from producing goods to making money out of speculating on inflating prices. Speculative activity does create some employment to be sure, but not employment that lasts. Eventually inflation endangers and disrupts job stability for it is during inflationary booms that the seeds of deflation are sown.

Nor will inflation cure structural unemployment that stems from shifts in the use of resources. A dynamic economy forsakes the old for the new, and so one may expect rapid economic growth to bring about some unemployment of a structural sort.

Currently, unemployment is less than during last year's recession, but it continues to plague the mining regions and areas dependent upon heavy industry. The list of cities with one out of eight workers jobless contains the long-suffering coal towns of Scranton, Wilkes-Barre and Huntington. These have been joined by Buffalo, Erie, and even Detroit, which has been the epitome of American initiative and mass production know-how. The rate of unemployment 20 months after the last cyclical peak in economic activity is only slightly above comparable experience in 1948-50, but is higher than the 1953-55 experience by about one percentage point. Such a comparison may comfort statisticians but not the families afflicted. Even though further expansion will tend to put the idle to work as overtime fails to satisfy the demand for labor, an unemployment level of about 4 million beings should lead us to question whether job opportunities would not be greater if some prices were lower.

As expansion continues, the rising investment demand stemming from industrial research and management initiative requires an increased flow of savings. If we are to remain competitive at home and abroad, we shall need not only capital for implementing technological advance, but competitive prices as well. Competition is, of course, a relative matter. How do our products compare with those of other countries as to quality, price and promptness of delivery? While ours have improved, foreign-made products may have been improving even more rapidly. Early this year our exports were down one-fifth from early 1957. This decline may be explained, in part, by cyclical developments abroad which reduced foreign demands for our raw materials and finished goods. At the same time, there is clear evidence that our cherished advantage in some types of machinery, as well as in autos and certain other mass-produced items, has been diminishing. This is a situation that will not be cured by ignoring it, or by the mere passage of time, or by passing laws. The sole solution lies in keeping our costs, including labor costs, competitive so that American firms may produce what enough people want, at prices they are willing and able to pay.

Prices were buoyant during the recent decline and subsequent recovery. In the recession, the industrial-price average fell only 0.6 per cent, though prices of crude materials slipped considerably as they had during 1953-54. However, prices of farm products and foods went up sharply early last year. As a result the total wholesale price index rose one per cent even while business was contracting. Since the turn-around in business activity in May 1958, the average of industrial prices has risen about 2.5 per cent and is now nearly 2 per cent above the previous all-time high. Though some capacity of human resources and manufacturing plants has remained unused, average industrial prices have risen sooner and faster than in the two previous recoveries when prices did not advance at a significant rate until after output had regained its previous peak. One may ponder the question: have we paid the fee for an adjustment we didn't get? Or are some selling prices still to be pushed downward by competitive pressure?

Last fall, Congress' Joint Economic Committee canvassed economists as to their views concerning the reconciling of unemployment with price stability. It sent questionnaires to members of 150 college economics departments. Replies were received to 615 of the questionnaires, or 40 per cent of the total number mailed out.

The first question read as follows: "Do you believe it feasible to achieve simultaneously both relatively high employment and relatively high stability of the general price level?" Of those responding, 60 per cent thought this achievement feasible even in the short run. An even greater number, almost three-fourths, believed it possible in the long run. This expression of informed opinion indicates a widespread belief that there is no inherent conflict between these two types of economic stability.

No one expects all individual prices to be stable. Indeed, some movement of individual prices serves an essential economic function. In our market economy, it is the normal way of getting a proper distribution of scarce goods and the most productive allocation of resources. Stability of the over-all price level is, however, a clearly desirable goal to the extent that it is attainable. How stable, then, should one expect the price level to be?

The economists polled indicated only a small tolerance as to desirable price fluctuations. To the question, "What in your judgment constitutes a satisfactorily high degree of price stability?" less than half replied. Of those who did respond, over 100 expected a maximum yearly price change of less than 2 per cent in prices to qualify as a satisfactory performance; another 75 indicated approval of a range no larger than 3 per cent in yearly price changes. I assume that the respondents had in mind random price fluctuations both up and down, and not secular, one-directional price movement. Even though this seems like a high standard, it has been more nearly achieved than many recognize. Since the starting of the Federal Reserve System in 1914, 44 years have passed. If the consumer price index is used to measure price variability during this period, its fluctuations have been less than 3 per cent in 25 of the 44 years.

This 44-year period, however, included some extremely large price changes, caused primarily by war financing and postwar readjustments. If we exclude the two World Wars and the period of Korean hostilities, the standard was met in 24 of 31 years. Excluding these wars, the accumulative price changes since 1914 just about balance out. Dr. Roland I. Robinson, of the Board's staff, has suggested that, without the influence of war, the current price level might not be far different from that prevailing about a half century ago. If all cyclical movements in activity could be avoided, we might then look hopefully toward a high degree of general price stability. However, as long as there are fluctuations in inventories or in business expectations, or international crises occur, it is not reasonable to expect complete stability in the over-all price level.

Continued bias in price expectations is extraordinarily damaging. There has spread to consumers an acceptance of the notion that creeping inflation is inevitable. This notion already has been accepted by too many purchasers of common stocks and real estate, and may have been overly influential in business decisions. It is itself a cyclically disturbing force. The risks of inventory accumulation in excessive amounts may seem abnormally small to business men if they feel certain that prices will rise. Thus one of the classic problems that has caused business instability is aggravated by lopsided price expectations. The price goal that would appear to be appropriate does not lend itself to precise description. It would be one in which no sharp changes in general price levels would be contemplated, but individual prices would be expected to move.

I turn now to rates of economic growth. Such rates, once of interest only to specialists, have now come under general discussion. The rates commonly cited, such as 3, or 4, or 5 per cent per annum, actually reflect two factors. One is the aggregate growth in economic resources, of which the principal one is population; the other is the increase in per capita productivity. While total growth may correctly measure our capacity to fight a war, the peacetime emphasis should be on per capita growth as the determinant of our standard of living and of our over-all well-being.

In recent testimony before the Joint Economic Committee, Dr. Raymond Goldsmith showed that for the past 120 years our per capita growth had averaged about 1-5/8 per cent per annum. Possibly a more significant point developed in his testimony, however, was that growth has taken place in periods of declining as well as of advancing prices.

Although the future growth rate might be increased, his evidence indicated that such a development is largely dependent upon technological advances bolstered by sufficient capital to take advantage of them. It is less influenced by the level of money or effective demand than is sometimes assumed.

Healthy growth of the economy can be attained only by a close gearing of bank credit expansion with that of the economy generally. Such growth requires that the central banking system provide enough but not too much money to achieve and maintain balanced growth without inflation. Recent historical research of the National Bureau of Economic Research shows that, while growth rates have fluctuated considerably in the short run, the growth process, if measured by decades, has been remarkably durable. Except for the decade containing the Great Depression, we have had appreciable growth during every decade for the last 70 years. A highly significant point brought out by this research is that growth was strong during the period of falling prices in the last third of the nineteenth century; and that growth was rapid during the decade of the 1920's when prices were fairly stable. This evidence suggests that price stability and rapid growth are quite compatible. The essential point is that per capita growth depends to a considerable extent on improving productivity. Productivity, in turn, depends on the existence of a flexible economic system, one ready to use advanced technology.

In the private sector of the economy, the free choice of the consumer and the free choice of the businessman dominate the use of our resources, as they should. Consumers have been devoting a smaller proportion of their income to the purchase of the products of factories, where statistical productivity gains have been great and a larger proportion to services where there is no statistical measure of productivity. Car repairing, hair cutting, and travel have been a growing part of consumer expenditures. Our national well-being has scarcely been diminished by the decision of many citizens to travel in order to secure first-hand impressions of their own and foreign lands. This shift from manufactured products to services, however, diminishes the statistical measure of productivity increase.

In the public sector, our expenditures should be carefully tailored to the necessities of international tensions and domestic needs. Public expenditures simply for the sake of promoting growth could be illusory and self-defeating. It is doubtless true that governmental expenditures for fundamental research can contribute to productivity in the long run, even though in the short run they have little connection with its statistical measurement. Government spending, however, will not enhance the savings required to provide the tools and other capital equipment needed by the economy. Nor will spending dictated by pressure groups achieve the changes needed for real and sustainable growth--in fact, it may impede such changes. Rapid economic growth stems from the shifting of resources, human and material, to new industries and from less productive industries and occupations to those of higher productivity.

A current situation illustrates the difficulty of measuring the nation's productivity, especially in government and in the service industries. Since 1953, hourly-rated factory workers declined by over a million even though the gross amount of physical product grew substantially. During the same period the number of public school teachers increased greatly. Because of the impossibility of measuring "productivity" of such government employees, the statistical measures of national product assume it to be unchanged. Whether or not this be true, medical and other services have shown qualitative improvement even though quantitative measurement of their productivity eludes the statistician. Yet most certainly public services such as education and health contribute greatly to the long-run growth and progress of the economy.

To sum up the argument thus far: inflation does not stimulate sustainable growth; it just creates a temporary illusion of it. Real growth requires that competition do its work both at home and abroad. Competition must be allowed to produce the kind of flexible change that brings out the maximum use of resources and does not allow inefficiency to hide behind the shelter of monopoly or other forms of protection. Rapid growth requires use of the most advanced technology. That which is inefficient and outmoded must be abandoned quickly. To employ some form of protection merely to preserve the status quo, whether through subsidies, tariffs, or featherbedding, is likely to retard growth.

I shall now attempt to show that prudent financial housekeeping is possible under conditions worse than ours. In fact, there are some distinguished examples of how effective monetary and fiscal policy can be when they work together as a team. For instance, in Italy, 1947 marked a turning point in post-war financial and economic development. Prior to the introduction of the defense of the lire policy, Italy had been in the grip of a severe inflation. Between mid-1946 and September 1947 wholesale prices had risen by 150 per cent. The cost of living had doubled, and paper money was being issued at a rate faster than the growth in national income. A new fiscal policy in combination with a tighter monetary policy ended this by (1) reducing the budget deficit to a level at which it could be financed by non-inflationary means (through Treasury borrowing out of savings, thus ending the resort to the printing press); (2) restraining the growth of credit to an amount consistent with the actual growth in real resources.

The effective contribution of Italy's stabilization program in escaping from its plight after World War II is indicated by the contrast between the doubling of the cost of living in about one year prior to 1947, and the 48 per cent increase in the entire decade that followed. Since the restoration of confidence in the currency, bank deposits have increased seven-fold. The real budget deficit, instead of being 40 per cent larger than revenue, was only 8 per cent ~~larger~~ of it in fiscal 1958, and last year the gold and foreign exchange reserves increased by nearly $700 million. These reserves are now the third largest in Western Europe.

It would be tragic if the United States fails to profit from the experience of other countries, like Italy, Austria and Germany. The painful lesson that inflation destroys savings and liberties was too well learned by Germans in the hyper-inflations of the 1920's and '40's to be forgotten soon. Surely our citizens will come to understand the causes and costs of inflation in time to avoid the consequences. Certainly if these European countries can overcome the ravages of war sufficiently to put their financial affairs in order, our own nation can achieve sound financial management. Experience is a great teacher, but why is she so often late to school?

Although inflationary price rises, especially of manufactured articles, tend to be curbed by excess capacity and increased efficiency, these fundamental economic forces need to be supplemented by observing prudence in many directions: fiscal policy, to avoid spending in excess of revenues; monetary policy, to prevent over-expansion of credit; wage setting and pricing policies, to keep our firms competitive. There is no easy short cut to sound financial management; nor are there obstacles that determination and self-discipline cannot conquer.