ECONOMIC GROWTH AND CHANGE

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, at the Farm Forum in Minneapolis, Minnesota on March 9, 1959.

This morning's program, under the general subject of "Farming-Past and Future," has covered at length many of the changes that have taken place and are continuing to take place in the agricultural segment of our economy. My assignment is the subject of growth and change in the economy as a whole.

In view of my own background in the field of agriculture and in view of the importance of farming and its interdependence with the rest of the economy, it is inevitable that I, too, may make some reference to agriculture. Nevertheless, I am delighted with this opportunity to take the broader approach for I have long disagreed with the idea that the farmer belongs to a separate class of citizenship with basic interests that differ from those of the remainder of the population. Nothing is further from the truth.

There was a time when the farmer was less closely tied to the rest of the economy. He produced his own tools and power, processed and marketed the products of his labor. He was largely independent of all other segments of the economy except the services of the preacher, the teacher, and the doctor, and he sometimes provided even those. This independence of others, however, meant that he was almost solely dependent upon his own resources and ability. At that time he made up a major portion of our population with most of his time devoted to production of food and fiber for his family, with a little over for the few nonfarmers who were dependent on him for their living.

That situation has changed. With a continuously decreasing proportion of our population engaged in farming, a correspondingly increasing proportion is dependent on someone else for food and fiber. At the same time the farmer has become increasingly dependent on others not only for the tools and materials of production but also for the marketing, processing, and distribution of his products. This same change has occurred throughout our economy with the result that all segments have become increasingly interdependent.

This increasing interdependence is an inevitable concomitant of growth. Since we all agree that growth is essential to our nation, the first task should be to explore what we mean by growth and to discuss the conditions that encourage growth. One kind of growth is simply an expansion of total output in line with expanding population. If we wish to raise our standard of living, however, there must also be an increase in productivity, that is, the output of goods and services per person. As I see it, such growth is based on five things.

1. Specialization of individual effort. This is exemplified by the line assembly and mass production in industry and, in agriculture, by the farmer's concentration on production while others provide his power, materials, and tools, and still others handle the processing and marketing of his products. Incidentally, it is this specialization and the concentration of many former farm activities into new off-farm industries that have accounted for much of the decrease in farm population.

2. A dynamic technology which improves productivity through better materials, better methods, and the increased use of mechanical power in

place of human labor. This requires imaginative leadership and a willingness to experiment. A society strongly bound by tradition resists change, including changes that would improve productivity. Increased productivity is most readily achieved in a society that is both evolutionary and dynamic. Increased productivity inevitably means that it takes less man power to produce a given item and that some man power can thus be released to produce the new goods or services that are constantly being developed by a dynamic technology. Without this development we would lack the man power to produce this constant stream of additions to our comfort or enjoyment. Fortunately, our country has been a dynamic one largely receptive to such changes. Yet even here we see evidence from time to time of the devastating effect of resistance to change on the life of an industry or segment of our economy.

For example, our railroads, fighting a competitive battle for their very existence, complain that they are constantly handicapped by the featherbedding rules demanded by labor in an effort to perpetuate jobs for which there is no longer any economic justification. We find another illustration in many of the restrictive building regulations which prevent that industry from availing itself of many cost-reducing methods and materials which have been developed. It may be that even agriculture is affected by this resistance to change in some of the efforts to support the continued operation of uneconomic units that are no longer able to compete in this day of advancing technology in agriculture.

We can readily understand the desire of anyone to hold on to the job that he knows and likes and the need in the economy as a whole to cope with the problems of technological unemployment. Yet it is both impossible and undesirable to attempt to stem the flow of technological developments if we expect to continue healthy economic growth. With the development of other competitive modes of transportation, no amount of feather-bedding could save the jobs of passenger crews whose trains were discontinued for lack of patronage. Increased availability of gas and fuel oil has cut the market for hard coal with a corresponding loss of jobs for miners. Attempts to maintain an unrealistic price for cotton have cost the farmers of this country an outlet, both foreign and domestic, for the products of thousands of acres of farm land. And the widespread consumer acceptance of a cheaper spread for bread has cut the dairyman's market for butter in half.

This leads me to pose two questions - (1) Would we not do better to attempt to strengthen our competitive position in all segments of our economy by taking full advantage of increased productivity? (2) Shouldn't we provide more incentive for the development of more new job opportunities and assist the workers released from fields of increased productivity to meet the needs of these new jobs rather than trying to withstand the inexorable pressures of progress, only to see the gradual decline of those segments that fail to adapt to the tide of change?

3. <u>An adequate flow of savings to supply the capital equipment.</u> As I stated earlier, increased productivity is the result of better methods, better materials, and the increased use of mechanical power for human labor. All of these involve the substitution of capital for human labor and no one knows better than the farmer the continuing need for increased capital as a result of the technological advance in agriculture. Over the long run, we have had a reasonably adequate flow of savings to meet our capital needs.

Our ability to meet this accelerating need in the future depends in no small measure on our confidence in the future value of our savings, a point which I want to touch on further a little later. Suffice it to say for the moment that adequate capital formation depends, first, on confidence in the future value of the dollar, and, second, on a rate of return that serves as an incentive for the saver to invest his savings because the higher the risk, the greater the incentive must be to induce him to incur that risk.

4. A well-distributed income so as to insure adequate purchasing power to acquire products of new and improved technology. In this connection, I would like to remind you that we have made considerable improvement in this direction and that widespread and comparatively high level consumer buying power has been one of the strong stabilizing factors in our economy. It seems to me, however, that we should give further consideration to the most equitable method of sharing the fruits of increased productivity. First, we should understand that growth can never be at a uniform rate throughout our economy nor constant over long periods of time. Economic growth, like plant growth, is subject to variations in climate and environment. The economic climate varies from time to time and from one segment of the economy to another. It is thus inevitable that we should find first one segment and then another forging ahead under favorable stimuli only to run into periods of diminished growth at other times. In fact, it is inevitable and even helpful in the long-term that from time to time we have periods of lessened activity when, in farm parlance, we can have time to prune the sucker wood out of the orchard. Any operation running at full capacity for extended periods finds itself falling behind in maintenance with efficiency dropping

and costs rising. It is only as demand slackens that we find time to overhaul the machine and get it back to its potential efficiency in preparation for a future growing period. While we all want to keep those slack periods to a minimum, we must recognize that some are inevitable and that they provide for optimum efficiency in the long run.

It seems to me important that we recognize three legitimate claimants to the fruits of increased productivity. With no implication as to relative importance by the order in which I list them, I would mention (1) capital, (2) labor, and (3) the consumer. I mention capital first because without capital there would be no means of procuring the tools and materials which make increased productivity possible. It is capital's share of the fruits that provides the incentive for the saver to accumulate and invest his savings. Labor, too, must have its share if it is to acquire the higher skills required to meet the demands of increased productivity. Both of these claimants have been generally recognized though at times one or the other may have sought to claim more than its due share. Too frequently, however, the consumer's share has been completely swallowed up by the first two. Yet only by recognition of the consumer's share through appropriate price or quality adjustments can the whole economy benefit. This includes the large group of pensioners and others dependent on fixed incomes, those suppliers of personal services who have little or no opportunity or possibility of increasing their productivity, and those engaged in other productive segments of our economy which happen to be in retarded stages of the growth cycle at the moment.

5. A product and price structure that stimulates adequate consumer demand. It is not enough to have just adequate purchasing power without a desire on the part of the consumer to acquire the goods or services offered. Farmers are well aware of the effect of changing food habits on the total consumption of farm products. Some of these are due to a better knowledge of our nutritional needs, some to promotional activities, and some to price. These same or other factors have varying effects on demand for all goods and services. In short, unless there is a consumer desire for the item in question and a belief that it is worth the price, there is apt to be little sale regardless of available purchasing power.

Now for a few moments I would like to talk about money and credit policy as it relates to economic growth, development and stability.

Without minimizing the danger of armed conflict and the necessity of adequate preparation against such an eventuality, I call your attention to the threat of economic warfare and to the vital importance of maintaining in this country a sound, vigorous, and competitive economy.

We have become, in a large measure, the banker of the world and around the world free countries are looking to us to maintain a stable dollar as a basis for world trade. In our attempt to help other countries, we have also given those countries advice about fiscal and monetary responsibility and about adjusting their economies to a sound basis. Today we are facing a large deficit in our national fiscal program partly in consequence of adjustments to the recent recession. In a number of countries the question is now being raised as to whether or not the United States can take its own medicine - whether we are going to show the fiscal responsibility that we have been advocating for others.

Furthermore, the rising level of prices that has been experienced in this country together with marked recovery in many other countries is placing us in an increasingly difficult competitive position in world trade. The effect of this situation is manifesting itself in several ways. Agriculture, with its tremendous and continuing increase in productivity, must find additional outlets for its products. The physical capacity of the human stomach places a limit on our ability to increase our domestic consumption of food. This means that we must find these additional outlets either in foreign markets or for use as industrial raw materials, both of which are dependent to a large degree on competitive prices. Industry, too, is finding itself priced out of many former foreign markets and is even facing increased competition from imports in our domestic markets. To meet this situation, it is increasingly resorting to a device not available to agriculture, namely, the establishment of foreign branches where lower production costs enable them to improve their competitive position in world markets. Thus, a continuing policy of rising prices results in fewer jobs and a reduced national income -- the very antithesis of the growth that we need not only for a rising standard of living but for the mere maintenance of our present standard for a rising population.

As you all know, there are strong indications of a resurgent fear of inflation. As we contemplate this threat, I think it is important to consider two phases of inflation. One form of inflation results from an actual shortage of goods and services. True, we are not operating some of our plants at capacity, we are not fully utilizing our labor force, and prices appear to be reasonably stable for the moment. However, this apparently stable price level is actually made up of two divergent components. While we depend a lot on averages, they can be most misleading. We have now, as in the earlier period, a drop in agricultural and food prices, masking a rise in other prices that may give us the complacent feeling that this average is doing all right.

Those of us who are interested in agriculture should be doubly concerned about this but I also think that the entire country needs to be concerned.

The other phase, more ephemeral and yet just as vicious in its effects, is the inflationary psychosis, the growing belief -- in fact, the conviction on the part of some people -- that inflation is inevitable. Having accepted that philosophy, they begin to take steps which they hope will hedge against it. One evidence of that is what is happening in the stock market. Apparently, a large number of people -- not only individuals but businesses and organizations responsible for trust funds, retirement funds, endowment funds of one kind or another -- have been switching more and more of their funds from debt to equity securities. Why? Because of present earnings? No. Because of prospective improvement in earnings? Well, maybe, but it appears they are influenced mainly by the feeling that inflation is inevitable.

Certainly, if we look at the long-range picture we know that over a time we have had a gradual and sometimes not so gradual crawl in prices. But also we have had corrective periods. It is true that in recent years prices seldom backed down very far before taking off to new highs although there have been some occasions when the downward correction was quite severe.

However, there were enough corrective periods so that there was always the discipline of possible correction which made most people more cautious in their long-range commitments.

But consider what happens if we accept as inevitable the belief that we are going to have a continuously rising price level without reverses. The minute we all decide that this is inevitable and begin to gauge our actions accordingly, inflation won't proceed at a gradual rate -- it will compound itself -- thus hastening and intensifying the effect of the inevitable reaction.

We hear talk from time to time about the cost of money, about high rates of interest. Nobody wants to see a higher price of money than is necessary but when we talk about controlling the price of money we are up against as difficult a problem as we would have in trying to control the price of anything else we use. We accepted price ceilings during the war under the stimulus of war enthusiasm and patriotism. Do you think we could enforce price ceilings and rationing today? If you do, you are more optimistic than I am. Neither do I believe that we can enforce ceilings on the price of money. Money rates also must abide by market processes if we are going to meet the justifiable needs of the community. Again I say, if we are going to induce the saving of the funds that we need to provide the capital investment for the continuing growth of this economy together with the growing demands on government, there must be assurance of continuing value and there must be incentive in terms of return on the money.

There is another thing aside from money and credit policy that enters into this inflation problem. That is the fiscal problem of our government. We have a tremendous budget deficit at the present time, and the budget for next year is now under debate in the Congress. It is not my place to say how much we should spend or for what purpose but I would remind you that it all has to be paid for in one way or another. In a period of relative prosperity and record levels of personal income, such as we have at present, it should be paid for out of current income. Of course it can be paid for through government borrowing. To the extent that this borrowing comes from the people's savings, the danger of inflation is minimized. But if the people, for whatever reason, including lack of confidence as to what government securities may be worth in the future, decide not to invest in them, not to use them as a repository for their savings, the government then has to turn to bank credit --and undue expansion of bank deposits means in effect printing press money and further dollar depreciation. The task of the Federal Reserve is that of keeping the expansion of bank credit in balance with the money needs of the economy. An adequate volume of voluntary saving, which goes willingly into fixed dollar obligations, not only serves to keep interest rates at reasonable levels but also helps the Federal Reserve to perform its task.

Here, let me interject a word about the farmer's concern with inflation. If it was ever true that the farmer benefited from inflation by being able to pay off debt with inflated dollars, it certainly isn't today, for two reasons. First, in the aggregate, farmers' financial assets approximately equal their debts so that any decrease in the cost of their debts is offset by a corresponding decrease in the value of their financial assets in the form of insurance, bonds, mortgages, and savings accounts. Second, with agriculture as a whole in a position of surplus production and with off-farm production items making up an increasingly larger part of his total costs, inflation is bound to have a greater effect on the farmer's costs than on his selling price. Experience since Korea is a glaring illustration of this fact.

It is true that farm land values are responsive to inflationary pressures and land prices have risen precipitately in recent years. Some farmers have sold their land to advantage but they have sold themselves out of the farming business. For operating farmers, land is a capital asset in which they must invest money. As the cost of the investment goes up, the overhead cost of production rises accordingly and the only way farmers as a group can profit from the widespread inflation of land prices is to go out of business. Furthermore, this increased investment cost compounds the difficulty for the new farmer trying to get a toe-hold.

In closing, let me remind you that the Federal Reserve System was created by Congress to be the steward of the nation's monetary system. As such, it is constantly concerned with the problems of inflation and deflation as they affect monetary stability and the sustainable growth of our economy. This stewardship is always open to review, as it should be. Monetary issues are constantly coming up for attention by Congress. At the moment they are receiving an unusual measure of public scrutiny by Congressional and Presidential committees and other agencies. In a period of such intense scrutiny, it is important that neither these committees nor the public be misled by misunderstanding or erroneous beliefs, such as the one still held by some that farmers are benefited by inflation. Only through a full understanding of our basic objectives and a recognition of the inevitability of change in a growing economy, can we be assured of the adoption of policies essential to the attainment of our national goal of sustainable economic growth. For this reason, I have welcomed the opportunity to participate in this program on the theme of "Progress through Change."