# SOME ESSENTIALS FOR ECONOMIC GROWTH

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, at the 35th annual convention of the American Cotton Shippers Association in New Orleans, Louisiana, on May 8, 1959.

It is not my purpose today to discuss the problems of the cotton industry for you have others on your program who are much more expert than I on those specific problems. Furthermore, I think there is an alarming tendency in all segments of our economy today to become so immersed in our own immediate problems that we overlook some of the broad objectives and problems incident thereto, on which the future of our entire economy depends.

Among the most important of these broad objectives is that of a sustainable economic growth. It is this objective and some of the factors essential to its achievement that I would like to discuss with you at this time.

We all agree, I am sure, that continued economic growth is both possible and essential to our nation. The problem is how best to attain it. The kind of growth we want is not simply an expansion of total output in line with expanding population. We wish to raise our standard of living, and for this there must also be an increase in productivity -- that is, in the output of goods and services per person. Such growth involves incessant changes and adjustments throughout the economic system -- in methods of production, in the kind of jobs people hold, in relative costs and prices, in government policies, and in business relationships with other countries.

We should understand, however, that growth can never be at a uniform rate throughout the 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. Slack periods in particular industries may signal the need and provide the opportunity to shift resources to other occupations. From time to time there is a general slackening of demand. While we all want to keep those slack periods to a minimum, we must recognize that some are the inevitable concomitant of growth and change and that they provide opportunities and incentives to overhaul the economic machine and improve its efficiency.

If growth requires change, it also facilitates change. It stimulates the search for new and better ways of doing things and makes it easier for labor and capital to shift from one product or occupation to another by creating new employment and investment opportunities. Often desirable adjustments can take place in a growing economy simply through more rapid growth in one industry than another. Thus, growth and change interact on each other.

A society strongly bound by static tradition resists change, including changes that would improve productivity. Fortunately, the very tradition of our society is growth. Our country has been a dynamic one, largely receptive to the changes that go with rising productivity and a higher standard of living. Yet even here, we see evidence from time to time of the harmful effects of resistance to change on the life of an industry or segment of the economy. As I see it, economic growth is based on six things.

1. Specialization of individual effort. This is exemplified by the assembly line 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, like yourselves, 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.

It has been this release of labor from the primary job of food and fiber production that has provided manpower for the multiplicity of new industries that are constantly emerging. How else could we avail ourselves of the increased productivity of new machines except by concentrating specialized activities in sufficient volume to justify the overhead cost of the machine? Illustrations of this are too familiar to need mention and I cite only two in your own industry -- the cotton gin and the modern textile mill. It is not difficult to imagine the scarcity and cost of cotton goods today if we still depended on the producer of cotton for the separation of the lint and the fabrication of the material by the hand methods of our forefathers.

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. Large expenditures for new plant and equipment, automation, rising outlays for research, the steady flow of new products and processes, and the widespread use of the "suggestion box" in our factories and offices all attest to the presence of these valuable qualities in this country.

There are, however, particular industries in which technological change has sometimes been resisted. For example, our railroads, fighting a competitive battle for their existence, complain that they are constantly handicapped by the feather-bedding rules demanded by labor in an effort to perpetuate jobs for which there is no longer any economic justification. We find another illustration in restrictive building regulations which prevent that industry from availing itself of many cost-reducing methods and materials that have been developed. Such resistance to technological advance within particular industries has a bearing on a third basic condition of economic growth.

3. Mobility of labor and enterprise. For the economy as a whole, much of any over-all increase in productivity comes from substitution among products made with varying amounts of labor, and from corresponding shifts of man power and other resources from lower to higher productivity occupations. Without such shifts we would not be able to produce the constant stream of additions to our comfort and enjoyment that a dynamic technology makes possible.

Often such shifts are resisted. 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 and withstand changing market forces 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 coal and there has been a more than corresponding loss of jobs for coal miners since the mines have also been further mechanized. Widespread consumer acceptance of a cheaper spread for bread has cut in half the dairyman's market for butter at present prices.

For raw cotton, as you are well aware, efforts to support the continued operation of uneconomic units have been concentrated on the maintenance of unrealistic prices. American cotton producers could profitably produce and market a large volume of cotton without artificially high prices and acreage restrictions. The domestic market would be larger at lower prices and export subsidies would no longer be required. Special assistance could then be concentrated on helping marginal producers to make the transition to other products or occupations. The reduction of domestic cotton support prices for the coming season seems to me a welcome step in the right direction.

Attempts to withstand the inexorable pressures of progress rarely prevent the gradual decline of those segments that fail to adapt to the tide of change. Workers and businessmen in a particular industry frequently seem to think that the erection of barriers to change will improve or at least protect their relative position. This may be true for the moment. They will usually fare better in the long run, however, by directing their efforts toward strengthening their competitive position or, failing this, by moving into other occupation. Otherwise, they may deprive the community of the full fruits of increased productivity for a time. But, ultimately, they drive the consumer of their goods or services into the arms of their more efficient competitor or even into the use of an alternative product or service.

This leads me to pose two questions: (1) Ought we not seek, in every sector of our economy, to take full advantage of opportunities for increased productivity? (2) Where technological and market changes call for a shift of resources from one occupation to another, shouldn't we provide incentives and assistance to facilitate the change instead of trying vainly to stave it off?

4. <u>An adequate flow of savings to supply the capital equipment.</u> As I stated earlier, increased productivity results from better materials and the increased use of mechanical power. All of these involve the use of new and additional capital equipment, which has to be financed by savings. Savings are also needed to finance new homes and schools. Over the long run, we have had a reasonably adequate flow of savings to meet our capital needs. In the future, as in the past, an adequate and sustained flow of savings and investment will depend, first, on confidence in the future value of the dollar, and, second, on rates of return that provide incentives for the saver to save and the investor to invest. When demands for new plant and equipment, together with those for housing and for government facilities, are rising and pressing against the available supply of savings, interest rates rise to keep the supply and demand for funds in balance. This is another illustration of the kind of change and adaptation that market forces dictate and that can neither be prevented nor safely interfered with.

5. <u>A well-distributed income so as to insure adequate purchasing power to acquire the products of new and improved technology</u>. 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 best method of sharing the fruits of increased productivity, an important factor in assuring broader distribution of purchasing power.

In the particular industries where productivity is advancing most rapidly, labor and capital both have a legitimate claim to part of the fruits of that advance. Too frequently, however, they swallow up the whole of the increase -- and sometimes the returns from a rise in prices as well; they pass on none of the productivity gain to other consumers in the form of lower prices. The most serious objection to this practice arises, I think, not from considerations of equity, but from the threat that it poses to continued growth. If all the benefits of increased productivity in any industry are swallowed up in wages or profits, that industry is, in effect, foreclosing the opportunity for further growth both in sales and employment which might reasonably be expected from a sharing of some of those benefits in the form of price adjustments. This is simply a recognition of the fact that price is a reciprocal of income in determining the purchasing power of the community in terms of either goods or services.

It is sometimes suggested that the way out of this difficulty is a dose of general inflation. But that creates a host of other problems which I want to touch on further a little later. Surely the simple solution is that the fruits of increased productivity should go partly to the labor and capital directly involved, but partly also to the consumer at large. These considerations lead me to a related point, my sixth basic element of growth.

6. Price flexibility and responsiveness to consumer preference. Most of the economic changes necessary to growth and occasioned by growth are effected through transactions in the market place. The provision of government facilities are the main exception; we decide through our political representatives how those shall be provided and paid for. Otherwise, the forces of supply and demand, as influenced by changing technology and consumer wants, work themselves out through markets and market prices. These provide the mechanism for making economic adjustments, the signals that indicate what adjustments are needed and the incentives to bring them about.

We all recognize that there is an unavoidable element of "stickiness" in certain prices; for example, contract prices may have to be agreed for an extended period ahead. And, in general, we do not want widely fluctuating prices that could produce exaggerated adjustments first in one direction and then in the other. But within these limits we must not forget that,in a market economy, one of the most important essentials for stable growth is appropriate pricing of the factors of production and of their products and that prices must change in response to changing conditions.

To return to cotton as an illustration, it is clear that artificially high prices for raw cotton have kept too many producers in the field. At those prices, consumers will not buy all the cotton that is produced and they are turning increasingly to synthetic fibers, paper, and other cotton substitutes. Neither can we overlook the importance of consumer preference, entirely aside from price. Again the illustrations are too numerous to even list and I cite only two - oleomargarine consumption, which increased over fourfold with the removal of the color restriction though it had little, if any, effect on either price relationship or nutritive value; and the consumer appeal, regardless of price differential, for certain qualities of some synthetic materials not heretofore available in cotton. Small indeed is the list of goods that are indispensable to our needs or irreplaceable by other products to serve a similar purpose, and the flexibility of our wants and our responsiveness to the appeal of something new or different is one of the wonders of our American economy. It is just as fatal to the continued growth or even existence of any industry to ignore the changing habits or preferences of the consumer as it is to ignore the threat of competitive productivity and pricing.

This sort of problem is present also in industries outside of agriculture. It cannot be solved by a higher general level of purchasing power but only by more realistic pricing of the resources and products concerned and a responsiveness to consumer preference, following the guidance of the market. Only thus can we set free productive resources, on the one hand, and purchasing power, on the other, and realize fully our growth potential. Again, I would suggest that to the extent that such shifts are difficult, we should work to make them easier instead of trying to prevent their occurrence.

Now for a few moments I would like to talk about more immediate growth prospects and about the related problem of inflation.

We have just emerged from a recession in which growth was temporarily interrupted and we are now moving forward to new high ground. We are currently in the most hopeful stage of the business cycle, when continued growth can confidently be foreseen for at least a year ahead, and -- more important -- when we have an opportunity to secure a sustained expansion over a much longer period, with only moderate fluctuations, if inflation can be avoided.

To do this requires wise decision-making not only by the Government and the Federal Reserve System but also, and especially, by businessmen, labor unions, and consumers. The recent recession, like earlier ones, illustrated the effect of inflation in intensifying an economic boom and the subsequent reaction. To the extent that private decisions were based upon overoptimistic expectations and upon the anticipation of continuing price increases, they not only contributed to inflation in the boom but produced an exaggerated reaction when those expectations were proved false. Fortunately, the recession was short-lived. We all have an opportunity now to avoid repeating earlier mistakes.

At present, the omens for stability are mixed but not altogether unhopeful. It is true that recent consumer surveys and the behavior of securities markets have indicated a widespread expectation of continuing inflation. It is also true that wholesale prices of industrial products have risen, on the average, 2 per cent since last June; the over-all price level has been stable only because of a decline in agricultural and food prices.

On the other side, however, the stability of the cost-of-living index over the past year and prospects for its continued stability in the months ahead remove an element of escalation in wages. Rapid increases in productivity and in profits certainly permit price reductions for the products of some of the most rapidly advancing industries. The discipline of the market can help to bring about such reductions if consumers show good sense and if the markets are allowed to do their work. Finally, there seems to be a growing realization that the Federal budget must not be a vehicle for adding to inflationary pressures in time of prosperity.

Developments abroad can assist us in securing growth with stability. The industrial countries of Europe and Japan are now financially and economically stronger than ever. They have shown a rapid rate of growth following recovery from wartime damage and dislocation and are currently emerging from a recession somewhat milder than ours and concentrated in inventories. Those countries are now determined to have growth without inflation and are competing with us more effectively than ever. This is an additional reason why we must avoid inflation in this country. But if we can do so, and hence remain competitive, we have an opportunity to share in the growth of other countries, as they share in ours, through foreign trade and investment.

Later this year members of the American Cotton Shippers Association will be feeling very concretely the beneficial effects of foreign trade. The reduction in domestic support prices for raw cotton, together with an increase in the export subsidy from August 1, will make American cotton export prices once more competitive with those of other cotton-growing countries. These changes will doubtless be accompanied by a reversal of inventory declines in cotton-importing countries. Those countries have held off buying cotton not only because American cotton was not competitively priced but also because cotton prices elsewhere were falling and because there was a world-wide recession in the cotton textile industry. That recession is now coming to an end abroad, somewhat later than in this country.

The triple stimulus of lower prices, rising final demand, and rising demand for inventories should make the coming season an especially good one for cotton brokers and shippers. Members of this audience will realize that the sharpness of this improvement in their business will not provide a reliable measure of longer-run growth potentials. I hope you will accept in the friendly spirit in which it is offered the suggestion that the good year for you that lies ahead should be regarded not as a time to relax, but rather as a time of opportunity to work even harder for wise private decisions and public policies that will contribute to the maintenance of effective markets, over-all price stability, and sustained economic growth.

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 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. Only if there is widespread recognition that inflation creates more problems than it solves and that change is inevitable 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.