P R O G R E S S   A N D   P R O D U C T I V I T Y

Remarks of

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I hope that my remarks today will be helpful by contributing something to your perspective on the current economic view. I am going to begin with a brief appraisal of that picture. That appraisal will lead to a conclusion I hold strongly and that I believe must become the core of the nation's economic policy.

Let me state that conclusion now. The finger of perspective points, I think, at a need for high and rising productivity. While other members of the Federal Reserve Board, notably Chairman Burns, have emphasized the need for increased productivity, let me note that the views I am expressing today represent my personal opinions.

We want--and as a nation our desires are expressed in the Employment Act of 1946--high and rising income, maximum employment of our human and natural resources and of our hard earned capital. We want high and rising respect for the dollar in international trade. This means that we want our goods and services to be competitive at home and abroad, so that we can earn and keep a basic balance in our international accounts.

We want to remake our cities. We want to invent the first society that offers everyone the opportunity to escape poverty without regimentation.

And we want to satisfy all these needs and desires at low and declining costs to the environment.

This is a requirement that we produce at lower unit cost in terms of wear and tear on the environment. Such a requirement calls for added industrial and taxpayer outlays that are large and long lasting. When we add that to the high consumption goals we expect our production to meet, the need to produce at the highest level of productivity we can sustain becomes as urgent as it is unmistakable.

THE CURRENT PICTURE

Let me now add up to this conclusion, beginning with the main elements of the current economic picture.

Industrial production is accelerating. The Federal Reserve's Index of Industrial Production rose sharply in April. This was the eighth successive monthly rise. In the first four months of this year, industrial production has risen at an annual rate of 9 per cent.

Employment is improving at a rate well above the long term norm. Approximately two and one-half million people were added to civilian employment rolls from May 1971 through May 1972. Nearly half this increase took place in the first five months of this year.

Despite this blooming of job opportunities, unemployment has not yet dropped significantly, because the civilian labor force has also grown at an unusually high rate, as it often does in periods of increased job opportunities.

Thirdly, surveys and figures on new orders both show that plant and equipment expenditure plans for the year are moving ahead well. Last fall, for example, one leading survey suggested a 7 per cent increase in capital expenditures for 1972. The most recent of the surveys by that firm shows a 14 per cent growth projected for the year. In between the two, other surveys also showed continuous increases.

The most recent Commerce Department survey of capital spending shows a 10.3 per cent increase for the year, however. That these projections have been increasing since last fall appears to indicate growing optimism among businessmen.

Finally, I would report that consumers are spending pretty well from their growing incomes. Retail sales have risen substantially this year so far. Car sales are strong--the rate for the last several months has been about 9 million domestic sales and 1 1/2 million imports--a good sales rate. And car sales are normally thought to be an unusually sensitive indicator of consumer attitudes.

Color television set sales have been excellent, and home furnishing sales are especially strong. In March, we had the largest increase in consumer installment credit ever recorded and the April increase also was substantial.

The only key indicator for which we do not yet have evidence of a turnaround is inventory investment. But, as a former manufacturing company executive, I am confident that growing consumer purchases and rising demands for business equipment will result in some inventory build-up shortly.

Thus, the prospects for a good solid growth in Gross National Product for the year are excellent. And the $100 billion consensus forecast may prove low.

As these growth factors continue to operate, we can reasonably expect unemployment to drop.

There is an irony hidden in this record of achievement. The growth so far in 1972 has occurred without the massive degree of fiscal stimulus that was expected to beget it. An unexpected over-withholding of income taxes--on the order of $8 billion at annual rates so far--has been the main factor in cutting the current budget deficit from the nearly $39 billion previously announced to some $26 billion announced in the mid-year budget review this week. The review also raised the fiscal 1973 deficit to some $27 billion. As 1972 evolves and we turn the corner into 1973, and fiscal stimulus plus inventory building occurs, the pace of economic activity can be expected to strengthen further. The problem for policymakers in the first half of 1973, then, will consist in a strong economy, little in need for further stimulus, but getting it from continued substantial Federal deficit spending--assuming that the projected Federal deficit ensues.

Thus, we appear to be moving into a period of quite substantial growth in the American economy. The problem for policymakers will be to sustain and encourage that growth while continuing to moderate the dangerous inflation we have been experiencing. We shall have to become conscious again of "demand-pull" inflation dangers, and find a narrow path between that threat and the "cost-push" inflation that has been the danger in the last two years.

THE CONTROLS

Some complain that Phase II controls are not working well enough. While I agree that the inflation we have suffered in recent years has been particularly stubborn, I do not believe it is appropriate to compare, say, the rate for the second quarter of 1972, which may be about 3 to 4 per cent, with the second quarter 1971 rate of 5 per cent.

The more appropriate comparison would be a comparison of what we have, with what could have been expected in the second quarter of this year had no controls been applied. As an until recently manufacturing executive, I am aware of the squeeze rising costs in 1971 were applying to profits, and the impetus this was giving to price increases.

President Nixon's program as implemented by the Congress took much of the steam out of the price increases being foreordained by the cost push of 1971. Substantial volume gains in the meantime--given the strength of the recent recovery--have bolstered total profits even though controls have held down prices.

In this respect, let me add that one of the strong reasons for believing that the economy is definitely mending is that business profitability is improving.

Corporate profits as a per cent of GNP in 1970 reached the lowest level in about three decades. In the intervening year and more, corporate profits as a share of GNP have generally risen. But the ratio to GNP has not yet come anywhere near peaks reached earlier in the post war period.

Some appear overly concerned now that the recovery over the near term is too strong. I have noted my consciousness of possible inflationary pressures in 1973. But, I think the facts that we are utilizing our manufacturing capacity at a rate of less than 80 per cent currently in this country, and that we have a 5.9 per cent rate of unemployment, do not suggest a need for choking off the stimulus to investment and expansion.

I am concerned that pressures for an end to controls may end their moderating influence prematurely. I desire a return to the type of economic freedom that has served us all so well for so long as much as anyone could desire it. But, in order for controls to be lifted successfully, we need to experience, for a reasonable period, a rate of inflation substantially less than we now have.

THE EMPLOYMENT PROBLEM

Earlier, I touched on growth of employment in recent months. This generally satisfying growth record conceals a troublesome element, not often highlighted. That is the continuing sharp growth in governmental employment.

While Federal Government civilian employment has held constant over the past twelve months--by dint of a special Administration effort--state and local governments have added one in four of the jobs created during that time. As a factor tending to ameliorate a serious unemployment problem, this development is commendable. But, as a long term trend in this country, sharply rising government employment is, to me, quite troublesome, for it underpins the rise of governmental spending at all levels that has been on a steep curve of increase for many decades.

In 1940, there were 32.4 million people employed in non-agricultural establishments in this country and 4.2 million were in government jobs at all government levels. In 1971, there were 70.7 million people employed in non-agricultural establishments in the United States and 12.9 million were in government.

THE PROBLEM OF GOVERNMENTAL SPENDING

From 1947 through 1967, Federal Government expenditures approximately doubled each decade. When the price inflation is taken out of these numbers, we still find an increase of 3 1/2 times over the two decades. And if the rate of increase in the five years since 1967 is projected through 1977, there would be another one-decade doubling.

More bothersome still, total expenditures by governments (State, local and Federal) have far outpaced the growth in the private sector of our economy in recent decades. Governmental expenditures were about 11 per cent of our Net National Product in 1929 while in 1971 they were about 36 per cent.*

It appears to me that one of the major short and long term problems in this country is to moderate the growth in governmental expenditures at all levels.

The short term aspect of this problem relates to the apparently unneeded fiscal stimulus which may well occur in the first half of 1973.

The long term problem is also a severe one. While the pressure for increased public expenditures and consequent tax increases seems inexorable, that pressure must be successfully resisted.

There are those, nevertheless, who suggest that we are miserly about expanding governmental expenditures in this country. And comparisons are drawn between the United States and Western European countries such as Sweden and England where higher proportions of gross national product are dedicated to the public sector. In my view, this would seem to be the wrong way to judge this problem.

I do not think any specific share of GNP devoted to public expenditure is the right proportion for all time and for all countries. But an increasing ratio of public expenditure to GNP carries with it the risk of reducing the potential long-run growth rate of the economy. Too often, the public is not prepared to decrease private consumption

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*Net National Product defined as the value of newly produced goods and services after allowance is made for the value of capital goods used up in their production.

to finance an increased use of resources by the public sector, so that government absorbs resources that would otherwise go into the capital formation needed for economic progress. Also, when rising governmental expenditures stem from programs that redistribute income, the effects on the tax structure may dull incentives to the point where individual initiative suffers.

THE NEED FOR HIGHER PRODUCTIVITY

This brings us to the heart of the matter. We have been rapidly losing our competitive posture in world markets because our costs--primarily labor--have gotten out of hand.

In recent years, productivity has increased only minutely in this country, although we did get a 3 1/2 per cent rate of increase in 1971 in the private non-farm sector. In the first quarter of 1972, the rate was a little more than 3 1/2 per cent, but compensation per man hour went up over 9 per cent, and unit labor costs increased about 5 1/2 per cent.

The first quarter was somewhat unusual, in that the large increase in compensation per man hour reflected the bulge in wage rates after the freeze. We can probably expect productivity increases of about 4 per cent or so in later quarters of 1972. If compensation per man hour were to increase by more than that, unit labor costs would continue to rise.

In my experience as a manufacturing company manager, I found that unions often resist increases in productivity while demanding continuous wage increases, although there have been notable exceptions. But, union leaders must understand--as each American must--that real income can rise only to the extent that men produce more. There is a simple equation that we must all live with: if we are to consume more per capita, we must produce more per capita.

Furthermore, it has often seemed relatively easy to management to raise prices enough to hold profit margins in the face of increased wages. What is truly difficult is to lower costs sharply through increased productivity. But, it can be done, and a firm relationship of increases in wage rates to gains in productivity is essential if we are to regain price stability.

Few realize that for a hundred years during the early history of this country--except for war time periods--prices generally fell. This sometimes occurred only at social costs not now acceptable. The point is that no such social costs must be levied in the name of price stability if we make greater productivity the password to higher wage rates.

In two relatively large manufacturing facilities which were part of my responsibility in recent years, we found through exhaustive studies that if the plants were removed to another location--almost any location--the work force could be reduced about 40 per cent. Decades of history in those plants with work rules and labor practices which severely limited output precluded all but modest productivity improvements over the short term.

High costs and low productivity are not confined to the factory floor. Many of our corporate management structures could be pruned to good effect. I endorse Peter Drucker's conclusion: "There is not one company I know of where a sharp cut in the number of executives would not be a real improvement. They are all grotesquely over structured."

There are few companies familiar to me that could not lower their overall costs by at least 10 per cent, and as much as 25 per cent or more, if two ingredients were present:

--a management with the will to manage

--a willing, cooperative work force

both of them understanding that income can increase in real terms only as productivity rises.

The problem of increasing our national productivity is such that I believe the time has come to embark upon a national crusade with the same sense of urgency that President Kennedy displayed when he launched our program to put men on the moon.

One of the more beneficial uses we can make of our tax powers is the provision of incentives to modernize production methods. Despite this, calls are now being heard to repeal the investment tax credit, or reverse the trend toward liberalized depreciation allowances initiated during the Kennedy administration. This would, indeed, be short sighted, in my view, tragically so.

Secretary of the Treasury Connally recently observed that some 40 per cent of our factory equipment was obsolete. In driving for lower costs, for example, the Japanese are tearing out steel production equipment we consider modern, in order to install larger volume, lower cost units.

From 1960 to 1968, the U.S. economy devoted a much smaller proportion of its total output to nonresidential fixed investment than other leading industrial societies:

Japan	31 per cent
Germany	19 per cent
France	17 per cent
United States	13 per cent

Thus, those who urge less incentive to modernize the industrial plant and equipment base of this country should appreciate two factors: the declining efficiency of American plant and equipment as compared to our competitors, and the growing importance of capital investment in a nation whose economy must become increasingly sophisticated if it is to continue to provide the income for the highest standard of living in the world.

The real key then to the restoration of the American economy to its old vigor lies in improving productivity at all levels and in all segments. And as productivity increases, salaries and wages should rise and prices should be stable or should fall.

I propose that we target a 5 per cent increase in productivity for each of the next five years.

We should set up management-worker-public productivity councils at local levels throughout the country to eliminate absenteeism and shoddy workmanship, and to lower costs sharply. And the workmen must be promised a substantial share of the proceeds of higher productivity. Where workmen have been given their share, progress in many instances has been remarkable.

We must think deeply about the fundamental reforms needed to cause both wages and prices to respond to changes in demand and supply.

President Nixon has in the last few months set us upon the path to new relationships and, I believe, healthier ones, with most of the great powers of the world through the realignment of the dollar, his call for fairer trade practices, his approach to the People's Republic of China, and the series of watershed agreements he negotiated at the summit in Moscow.

But, let us remember that we cannot follow through on these promising initiatives if we present to the world, and present to ourselves, a high rate of inflation and an economy ever less capable of competing on an even basis with the many economic powers that are on the rise throughout the world. Greatness begins with soundness at home. Insofar, at least, as our economy is concerned, greatness begins with high rates of gain in productivity and the maintenance of wage rate increases commensurate with productivity gains, so that prices can remain stable.

The keystone is not the whole arch, nor the arch the whole structure it supports. Productivity is not the whole story. But the arch will not stand without its keystone. And productivity gain is the keystone to the economic progress we must have if we are to keep our place in world affairs, providing the leadership the world seeks and deserves and continuing to demonstrate that America provides Americans with the highest quality life in the world.

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