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PROBLEMS AND PROSPECTS
IN THE AMERICAN ECONOMY

Remarks of
John E. Sheehan
Member
Board of Governors
of the Federal Reserve System
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I should begin by saying that the following comments are my personal thoughts and they cannot be taken as representing, necessarily, the views of my Board colleagues either individually or collectively.

I want to establish this at the outset not only for the obvious reasons but also because there does seem to be some confusion extant that this or that Federal Reserve Board Governor was putting up a trial balloon for the Board or was presumed to be speaking for the Board.

In a great majority of instances, the Chairman is the Board's spokesman. And it is only in his absence or in a matter such as Governor George Mitchell's testimony recently before a Congressional Committee on the taxation of banks that members other than the Chairman speak for the Board. But each of us, from time to time, find it helpful to air our personal thinking on a relevant issue in order to have the benefit of an exchange of views with the interested public, and it is in that spirit that I speak today.

In the following, I intend to touch lightly on defining for you the principal functions and purpose of the Federal Reserve System, and then focus briefly on three critical problems which the country faces, and with which you as businessmen should be concerned.

**WHAT IS THE FEDERAL
RESERVE SYSTEM ?**

Some of you may consider it too elementary for me to take a few minutes to spell out for you what the Federal Reserve System is. But I have been frequently surprised at the relative naiveté of many American businessmen with regard to the Nation's central bank. In Europe, the term 'central bank' is rather well known as the bankers' bank. And the Federal Reserve System is the lender of last resort. Mr. Nixon's associates, in discussing it with me last Fall, described his perception of the Federal Reserve Board as the 'Supreme Court of American finance'.

We are the fiscal agents of the United States Treasury -- their banker. We advise the Treasury, the Congress and the President on matters of both national and international finance.

The Federal Reserve holds some \$70 billions of U. S. Government obligations. It operates 12 district banks and 24 branches of those banks, with a staff of some 23,000 people nationwide. Of course, one of our banks is here in San Francisco.

The Federal Reserve processed about one-third -- 7.7 billion -- of the 24 billion checks written in the United States last year.

The Federal Reserve regulates the supply of money in the economy, providing more or less depending on whether economic activity is growing

less or more rapidly than is desirable. Thus, the Federal Reserve influences directly the price of money -- interest rates -- and has a considerable influence on the level of economic activity in the country.

Dr. Arthur Burns, Federal Reserve Board Chairman, has made some observations in recent years which summarize quite well, I think, the purpose of the Federal Reserve:

"Our obligation as a central bank is to promote monetary conditions conducive to full employment, rapid improvement in productivity, reasonable price stability and equilibrium in the balance of payments...also...to serve as lender of last resort.

The Federal Reserve would use all the authority at its command to ensure that unusual demands for liquidity were met.

I believe the Congress was wise in setting up the Federal Reserve System in a way that protects it from political pressures.

I believe that independence of the Federal Reserve... is an independence within the government, not of the government.

We must formulate (regulatory) policies that are consistent with the safety and soundness of the banking system (and) with market principles...to avoid introducing artificial constraints upon the free play of market forces...

I look forward to the day when the rate of inflation would be precisely zero...

A searching re-evaluation is...needed of the roles to be played by gold, reserve currencies and special drawing rights in settling international accounts..."

THREE KEY PROBLEMS

Let me touch now on three problems which I believe should concern businessmen at this juncture. The first is burgeoning Government expenditures at all levels.

EXCESSIVE GOVERNMENT SPENDING

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

More bothersome still, total Government expenditures (state, local and Federal) have far outpaced the growth in the private sector of our economy in recent decades. Government 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 then that one of the major short and long term problems in this country is to moderate the growth in government expenditures at all levels.

* Net National Product is 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.

The short term aspect of this problem is being well covered in the debates now in progress in the Congress relative to a Federal Government spending limit of \$250 billion.

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. All of the Nation's social problems cannot be solved by Government spending.

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 GNP 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 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 re-distribute income, the effects on the tax structure may dull incentives to the point where individual initiative suffers.

**THE NEED FOR HIGHER
PRODUCTIVITY**

While both fiscal and monetary policy are fundamentally important to the successful functioning of our economic system, the level of productivity is of overriding significance to our economic health and its degree of improvement must become the focus of an intense national effort.

The economic dilemma confronting us today in the United States arises primarily from one simple fact -- our costs, primarily our labor costs, have gotten out of hand. On hearing this, many of you are no doubt mentally damning the unions. But those who do should ponder several things. First, real worker take-home pay did not increase from 1965 to 1970. And, secondly, unions often exist because some managements have failed.

In order to improve productivity sharply, we need to reeducate our managements and work forces in a fundamental way so that both will join one team to lower America's costs and help the nation become more competitive in both American and international markets.

Management, in too many instances, considers labor the enemy and vice versa. But might we not take a lesson from the Japanese? Cannot management, labor and Government drop their mutual mistrust and work in harness to move the level of productivity up sharply? Some months ago, I called for a national objective of a 5 per cent increase in productivity for each of the next 5 years. The historical average has been 2.9 per cent in the private economy, over the past twenty years.

Technology will have much to do with the sharp improvement the nation needs. So will retaining the fast depreciation of equipment write-offs and perhaps enhancing them. Give the men the tools and we will be well on the way. But what will truly 'get us moving off the launching pad' is a major change in Government/labor/management relations. What we need is a productivity crusade.

We must educate managements and work forces everywhere -- in our factories, our hospitals, school administrations, public administration, Government -- that wage increases ought to rise no faster than productivity. Three per cent is the record over the decades for productivity gains in our economy. We now have a 6.25 per cent wage standard adopted by the Pay Board.

If we are unwilling to reduce that to a 3 per cent wage standard, then we must move productivity growth to 6.25 per cent -- or both must move toward some point in between. The arithmetic relationship is precise.

How can we substantially improve productivity in this country? One important element of a national crusade would be to offer the work force wage increases in the form of bonuses related solely to improved productivity derived from the effort of the work force. Separate out the effect of capital equipment or increased sales volume on costs. In a hypothetical example, let's suppose that labor costs in a factory are 40 cents of each dollar of costs

in a given period, such as the first nine months of 1972. Assume that through improved motivation, cooperation between the factory management and the work force in improved work rules and methods and the like, that costs could be reduced to 35 cents per dollar of costs in the fourth quarter. Then why not give the work force 3.5 cents of the lowered costs, for example, or some other figure to be negotiated with the work force as a bonus?

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 nonfarm sector. And we have had a 4-3/4 per cent annual rate of increase through the first half of 1972.

In my experience as a manufacturing company manager, I found that unions often resist increases in productivity while demanding continuance of wage increases, although there have been notable exceptions. But they must understand -- as each American must -- that real income can rise only to the extent that men produce more. And American labor should be given wage increases currently at the rate at which they increase productivity.

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.

Steel has been one of the great industries of this country for decades. How is it possible to take scrap from the docks of Cleveland, iron ore from the North American iron ore ranges, coal from the Illinois and Kentucky coal fields and haul these heavy, relatively low cost materials two-thirds of the way around the world, make steel on the coast of Asia -- a relatively low value product (6-7-8 cents per pound) -- haul that finished product two-thirds of the way back around the world and undercut a United States producer's selling price in its own local markets by some 10-15-20 per cent?

Yes, it is true that the Japanese have relatively low wages. But their high productivity is a sight to behold. There are those in the steel industry who suggest that on average the Japanese are not yet competitive with the American steel industry on a man hours per-ton-of production basis. And that is true -- on average. But we are told that the most recent Japanese steel installation is more competitive than the most recent integrated American steel plant -- and by a wide margin.

Having visited a large number of manufacturing facilities in Japan on many occasions, I can personally attest to the efficiency of the Japanese in manufacturing. I suggest that American businessmen pay for trips of their union executive committees to Japan to tour those factories and see how men can truly cooperate in the national interest.

And, getting personal, I doubt if there is a man in this room who cannot increase his output beginning tomorrow morning by 10 per cent. If there is an operation in this city that can't cut its costs by 10 per cent, I'd like to see it -- it will be my first.

Give the workman a participation -- both in the form of the pride that he should feel as a key part of the effort as well as a meaningful financial participation in the result. Make the shop a pleasant place for a man to spend his working life and give the workman a share in the increased productivity. But insist that his wage increase depend on productivity increases that he causes.

**WHO SPEAKS
FOR BUSINESS ?**

The third problem you should carefully consider solutions for is this: Why does American business management not stand up and be counted? Think back to the events of August 1971 and then try to recall the subsequent headlines. Which national leaders got headlines for their bold and outspoken comments on behalf of their constituents? Well, several labor leaders did, for starters. And incidentally, there is hardly an informed individual in the country who doesn't know who our key union presidents are and where they stand on the major issues.

But where are their counterparts in the insurance industry, in manufacturing, in banking and in commerce? Yes, we have a banker or two who

will speak out. And, on rare occasions, an intrepid corporate chieftain will, as well. But only rarely. Few can apparently take the 'heat of the kitchen'.

Who do you know personally from your area of the country on the Business Council? And who is its Chairman? When did he last speak publicly on your behalf and what did he say? Can you name 5 of the 50 members of the Business Council? Who is the head of the U. S. Chamber of Commerce? Do the views of these men command as much public attention as those of the leading union or Government officials? If your answer to these questions is 'No', then you ought to be trying hard to develop outstanding long term leaders to speak effectively for American management in the national interest.

CONCLUSION

I have touched on three problems which businessmen should be vitally concerned with:

- rapidly escalating Government expenditures at local, state and Federal levels;
- the need for a dramatic improvement in the Nation's productivity;
- the lack of effective, vigorous business voices on the national scene speaking in both the interest of business and the Nation.

Given the progress of the past two centuries, our prospects as a Nation are bright, indeed. What we need to assure ourselves of that

**brilliant future is the will to work together -- labor, Government and
management -- using our abundant resources at substantially higher levels
of productivity.**

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