Statement by Mr. Robert P. Mayo, President,
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to the Joint Economic Committee
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It is always a pleasure, gentlemen, for me to appear before your Committee to offer whatever assistance I can in your deliberations. Today, on the eve of the bicentennial celebration of the Nation's birth and the 30th anniversary of the Employment Act of 1946, it is particularly fitting that a review be undertaken of the performance of the Nation's economy under that Act.

I have always considered the Employment Act a major step forward in economic policy, not only because it recognized a duty on the part of the Government to act in the economic interest of its citizens, but also because it established the Council of Economic Advisers, the regular reports of the President and the Council, and last, but certainly not least, it initiated this Committee itself, which has offered a national forum for economists of all views to educate the public on economic issues.

The Act is not perfect and steps to implement its goals have sometimes had perverse effects, but no one can quarrel with the goals it espouses--maximization of employment, production, and purchasing power. Today, with the country's economy in the early stages of recovery from the most severe economic setback since the Act was passed, the progress that has been made since 1946 may not be the first thing to come to mind, but as one thinks back to the period between the two World Wars and the fears in people's minds that a repeat of the post-World War I behavior was due after World War II, the contrast between expectations and performance is truly amazing.

The inflation which began in the mid-1960s and which is still with us, though slowly ebbing; the recession from which we are just beginning to recover; the tremendous need for our agricultural products overseas; and the growing threat of energy shortages--all of these strongly suggest that it is essential that we examine what can be learned from what has gone wrong with our implementation of the Act, particularly in the past decade. We must restore the American economy to a non-inflationary, stable growth path, which can fulfill the average citizen's aspirations once more without the excesses we have witnessed.

The Midwest Economy

In order to assist the Committee in developing appropriate approaches to our economic problems, I would like to focus today on the extremely important role that the Midwest plays in the national economy, on the impact of the recession on the Midwest, and some of the particular problems which the area faces over the next several years.

In discussing the Midwest, I am referring to a much broader geographical area than the portions of the five states served by the Federal Reserve Bank of Chicago. In my mind, the Midwest consists of the twelve-state area designated by the Census as the North Central States. These are Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

This twelve-state region is, in many respects, the economic heartland of the United States. Indeed, it may be the economic heartland of the world! There is virtually no facet of the economic life of the nation that is not profoundly influenced by the contributions from one or more of these twelve states.

The Midwest occupies about one-fifth of the nation's land area and contains just over one-fourth of the population. In a typical year the residents earn an income slightly above the national average. Several of the states are thought of primarily as agricultural producers and, indeed, the region has awesome farming capabilities, including just over a third of the nation's total farmland, and accounting for nearly half of total farm sales. The region's manufacturing capacity is also immense, accounting for more than a third of the nation's output.

Agriculture

Midwest agriculture is broad-based and large by almost any measure. It encompasses the vast wheat fields of the plains states and the Corn Belt in the heart of the Midwest that provide the bulk of domestic feed grain production. Virtually all of the states in the Midwest are major livestock producers. Moreover the Great Lakes region of the Midwest includes several major areas of specialized fruit and vegetable production. Seven of the twelve Midwestern states were in the list of the ten states with highest cash receipts during 1974.

Among major individual commodities, corn, soybeans, hogs, and cattle are most prominent in the Midwest. Nearly seven out of every eight bushels of the corn produced in the U.S. comes from Midwestern fields. At the same time, midwestern farmers produce more than 7 out of every 10 bushels of soybeans. Over three-fourths of the nation's inventory of hogs and pigs are located on farms in the Midwest. Although midwestern farmers own only two-fifths of the inventory of all cattle in this country, they are responsible for over one-half of the cattle on feed--the major source of the nation's annual beef production. Nationwide, cash receipts from the marketings of these four commodities account for nearly one-half the receipts from all farm marketings.

Manufacturing

No less awesome is the Midwest region's contribution to the nation's manufacturing output. From screws and fasteners to gigantic industrial and mining equipment, the panoply of manufacturing is represented in the Midwest. Importance of this activity must be measured not only by output itself--over a third of the Nation's--but also by the fact that the bulk of the machinery and equipment the rest of the Nation and, indeed, much of the world needs to carry on manufacturing activity is produced in the Midwest.

In major durable industry groups such as primary and fabricated metals, nonelectrical machinery and transportation equipment, the Midwest supplies between 40 and 50 per cent of the Nation's total output. When finer industry breakdowns are considered, the Midwest is found to produce over three-fourths of all farm machinery, 70 per cent of all motor vehicles and parts, and over half of all metal working machinery and construction equipment.

Not only is the Midwest strong in producer durable goods manufacturing, the region is also a major producer of consumer durable goods. In addition to motor vehicles, already mentioned, the region supplies more than one-half of the nation's television sets and household appliances.

Exports

This combination of manufacturing and agricultural capacity has made the region a major factor in U.S. exports. In 1972, the last year for which complete data are available, over 40 per cent of all exports originated in the Midwest. It seems likely that the increase in the value of farm exports since then has increased the proportion so that today about half the Nation's total exports comes from these twelve states.

Finance

Of course, there have to be sources of credit and other financial services to support this enormous business activity.

Chicago is second only to New York City in possessing the attributes of a financial center. But the Midwest area boasts at least seven or eight other major cities that are able to provide sophisticated financial services to meet the needs of businesses, farms, and households. Because of the fluidity of money markets nationally, there need not be a close relation between the volume of activity and the volume of credit for a given region. Nevertheless, most individuals and businesses depend on nearby institutions for their financial services.

Aside from the sale of stocks and bonds by major business firms, the commercial banks of the region provide, either directly or indirectly, much of the region's own needs for credit to support both business working capital and consumer purchases. The region's savings and loan associations provide the backbone of mortgage financing. In both agriculture and housing finance, of course, the Government-sponsored credit agencies also play an important, although marginal role.

Almost half of the Nation's 14,200 banks and one-third of its S&Ls are located in these 12 Midwestern states. Midwest banks account for over half of the agricultural loans made by all U.S. banks, almost one-fourth of business loans and one-fourth of total deposits.

The growth in the use of credit since 1946 has been enormous. Commercial bank assets show a four-fold increase, but outstanding credits have multiplied by 17 on business and farm loans, by 18 on residential mortgages and by 35 on personal credits--all roughly in line with national trends. Growth in S&L mortgage portfolios was even more spectacular, largely because they started from a lower base. Besides this huge expansion in private credits, Midwest banks acquired almost $30 billion of state and local obligations.

Because of their vital function as custodians of the public's money and their ability to influence the allocation of credit, financial institutions are highly regulated. There are a number of important questions that must concern us as we review the thrust of this regulation in the public interest and within the spirit of the Employment Act. What kind of financial structure can contribute most to maximize income and restore full employment? To what extent should we encourage the flow of investment funds through intermediaries such as banks and S&Ls and how far should they be permitted to expand their noncredit services through the holding company route? How much should the various types of financial institutions be homogenized and freed from certain restraints on competition for funds and what they can be used for, as is implicit in the proposed Financial Institutions Act now under consideration by the Congress? The great Midwest, with its diversification of both activity and size of banking organizations, could well provide a testing ground.

International Finance

For much of the past 30 years, midwesterners have tended to use the trade-related international banking services of banks located in the port cities of the East and West Coasts. This was true even though exports played a major role in the Midwest region's economy. The decade of the Sixties, however, was a period of dramatic increase in foreign investment by Midwest-based corporations as they established one subsidiary and manufacturing branch after another overseas. Midwestern banks reacted to this growing internationalization of their traditional customers with a similar rapid increase in their ability to provide international credit and financial services. Head office capabilities were enhanced and overseas branches were established to service customers in foreign markets. Several Midwest banks have also established international banking facilities in New York and other coastal centers.

The development of these very significant capabilities to service the international banking needs of Midwest-based customers has not gone unnoticed by the major money market banks. Six coastal center banks have located international banking facilities in Chicago to compete for Midwest business rather than attempt to continue to attract them with services from their head offices. Foreign banks have also decided that a Midwestern location is now competitively desirable. Twenty-four foreign banks have located in Chicago to service the Midwest market. These banks bring to the Midwest a home country and other geographic area expertise which should prove extremely valuable to an increasingly internationally minded Midwest.

Recession Impacts

Over the past thirty years, the economic growth of the Midwest has generally followed the growth of the Nation as a whole, with periodic setbacks during the various recessions which have occurred. Per capita personal income of the region, for example, was almost four times larger in 1974 than in 1948--a rate of growth only slightly slower than that for the Nation as a whole.

Within the region there has been great variability in economic activity from state to state during economic downturns. Even within individual states, local economic conditions can be very different from the broad picture one gets from looking at the data for the entire country. In almost every instance, however, the big ups and downs in employment, in personal income, in output, or whatever measure you select to evaluate economic conditions has been the result of changes in the levels of manufacturing activity, and, particularly, durable manufacturing activity.

For the state of Michigan in general and the Detroit metropolitan area and its immediate hinterland, manufacturing activity and the automobile industry are almost synonymous. Unemployment in Michigan has generally tended to be somewhat higher than the national average. The only recent exception was during the 1967-69 period when Vietnam war production of vehicles and related equipment drew heavily on the State's capacity. But the influence of the auto industry is pervasive. In 1958, auto production dropped over 30 per cent from the 1957 level and the unemployment rate in Michigan shot from an average of about 6 1/2 per cent to nearly 14 per cent, and, on a monthly basis nearly tripled in a three-month period. The decline in production in 1974 from 1973 levels was almost as severe--about 25 per cent. The burst in unemployment was somewhat slower in coming as the auto companies were late in adjusting to slower retail sales. As a result the peak unemployment of over 15 per cent was not reached until last March. The decline in unemployment has been very sluggish since then even though auto production rates are increasing slowly.

In Illinois, economic activity also receded initially at a less rapid pace than in the Nation as a whole. For a variety of reasons, including the continued strength of steel manufacture as users' inventories were built up late last year, the fact that the machine tool industry, although faced with shrinking orders, was still working off a very large backlog, and continued strength in farm machinery production, the rise in unemployment lagged the national rise throughout the latter part of 1974 and early 1975. But in the last few months, unemployment in Illinois has started to rise more rapidly and is still climbing at last report. This is unusual since even in the most severe of the post-war recessions, Illinois has almost never experienced an overall unemployment rate above the national level and has usually been significantly below it.

Economic activity, especially in Michigan and Illinois, has also been affected by the changing fortunes of the various home appliance and consumer electronics industries. All segments of this group are strongly influenced by housing starts. In past recessions, housing has tended to be the spark plug of recovery, thriving when demand for funds was weak elsewhere in the economy. This has not occurred this time around. The boom in housing which preceded this recession, combined with the boom in mobile homes, and those units intended as vacation homes in resort areas, outraced demand by a substantial rate. At the same time, the rate of cost increase--in land as well as in construction--was so rapid that we have now reached the point where the typical prospective buyer cannot afford to buy the typical home, and this would be true even if the current mortgage interest rate were substantially lower. And the same kind of speculative overbuilding which engulfed housing has also occurred in commercial construction. No major city in the Midwest is without a glut of unoccupied downtown office space. At the same time, states and local governments, pressed for funds as receipts have tapered off and costs have accelerated, have slowed public construction.

Prospects

The resulting pattern for the recovery of the economy of the Midwest and the industrial states of the area seems clear. The national recovery is likely to be moderate and without the stimulus commonly resulting from the whole construction industry. It is likely to develop along a broad front led by steady growth of consumer purchases of nondurables and services. This being the case, it seems likely that the lag in recovery here will be longer than usual on the upside, and those industries which lag the most, the capital goods industries, will be bringing up the rear once again.

For our big cities, and Chicago is a good example, the problem of slow recovery will be exacerbated by the continuing movement of employment opportunities from the city to a progressively wider area around the city. While Chicago is making a valiant effort to find ways to preserve manufacturing jobs within the city and even to find ways to expand these opportunities, the lure of easy access along the interstate highways, lower taxes, and encouragement of a wide variety of incentives from outlying communities will continue to draw away the job reservoir of the central city. This means that the central cities in the Midwest will tend to follow a slower recovery path than the total metropolitan areas; that the metropolitan areas will lag the performance of the state and regional areas; and that the entire Midwest will lag the national economy.

Inflation and Unemployment

If the severity of the current recession proves anything, it is that, over the long term, continuing inflation is incompatible with continued low levels of unemployment. While I am well aware that the shortage of energy and the dramatic increases in its cost imposed by OPEC, the sharp increases in demand for U.S. farm production, and similar problems have contributed to the amount of inflation during the past three years, a major cause has been the apparent inability of the Federal Government to control deficit spending. In the entire period since 1946, the Federal budget, computed on the unified budget basis, has been in surplus only seven times and the total of all seven of these surpluses has been exceeded in each of four different years.

I do not think that any economist, regardless of his theoretical or political stance, would deny that this continued large deficit level has been a major causative factor in the long period of accelerated inflation we have seen. For many years, the public, organized labor, the business community, and even many economists failed to recognize that the use of deficits to overstimulate the economy would eventually begin to destroy jobs, not create them. We have certainly learned our lesson with a vengeance, and I am not surprised that even with unemployment above 8 per cent nationally and above 10 per cent in many major metropolitan areas, one public opinion poll after another shows that inflation, not unemployment, is now viewed as our major economic problem.

While part of our deficit was accumulated as a result of failing to use more tax financing of the Vietnam war, significant portions are the result of focusing excessively on the correction of short-run unemployment problems without thought to the consequences on purchasing power and of failing to consider fully the priorities which our scarce resources should meet. Until recently, new program initiation has been handled piecemeal so that final total expenditures are the sum total of a group of independent decisions, not an ordered set of priorities. Major new permanent programs have been initiated without more than a cursory examination of the long-term costs. If further recessions like the one from which we are only now emerging and if even worse inflation is to be avoided, we must have a long-term planning capability.

There has always been a strong prejudice among Americans against overzealous Government planning. And for good reason; we are all soundly convinced that the essence of our industrial strength, our agricultural superiority, and our high standard of living are all the products of an essentially free enterprise economy. We have no interest in a rigidly planned economy.

At the same time, we must be careful to distinguish between planning as it applies to a smothering of our basic freedoms and planning as it applies to the orderly and efficient management of those functions which Government is already convinced are proper to undertake. In those areas, we must match up long-term priorities with the long-term availability to finance them in the same way programs and funds are matched up on a short-term basis. We must begin to think in terms of reconciling conflicting goals and arriving at workable compromises.

Congress has provided itself with the tools for its own planning, budget setting, and control mechanism, a step I have consistently and strongly advocated. Although this year is only a trial run, I am pleased that the mechanism appears to be working. I am hopeful this effectiveness will be even greater in fiscal 1977, when the choices of policy and program may well be more difficult than they have been this year. I am convinced that such efforts to organize and match our priorities and resources are the major route we must follow if we are to achieve the goals of the Employment Act of 1946.