

National Instalment Credit Conference
Conrad Hilton Hotel, Chicago
March 10, 1959

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CLIMATE FOR GROWTH

I am happy to be a part of the program for this thirteenth annual meeting of the National Instalment Credit Conference. If I read the record correctly, the first of these meetings was held in 1941, but World War II forced postponement of the annual schedule for some years, so that your regular program dates from 1947. Since I am going to talk about economic growth and growth is essentially a long-term development, it occurred to me that this talk might begin by looking at the growth record from 1947 through 1959 and at the record for the thirteen years just preceding, 1934 through 1947. That gives us a quarter century or a generation to look at.

We tend to measure growth mostly in terms of material or real output of goods and services. Our best overall economic measure is the well-known Gross National Product which represents the dollar value of all goods and services produced for consumption by business, individuals, government and net exports. Ordinarily Gross National Product figures are given in terms of current values or prices, so to get real or physical changes we have to adjust for the price factor. If we do not do this, we sometimes get the illusion of growth when actually there has been nothing but price change.

In real terms the Gross National Product increased a little more than 100 per cent from 1934 through 1947. Taking the estimated level of GNP for 1959 that underlies the President's budget message, the gain from 1947 through 1959 will be a little more than 50 per cent. If we use 1958 prices to value all of this output, we find that the real increase in each period approximates \$160 billion. Thus the net gain in output in each period was approximately the same. The fact that the percentage change in the latter period was just half that of the former reflects the higher base in 1947 than in 1934.

Now, I must confess that I have used this example to highlight some of the things I want to say about growth. While all of the statistics are correct, the example can give an erroneous impression.

To begin with, taking 1934 as a base year is bad. We were just emerging from the depths of the Great Depression, when only 1933 was a worse year than 1934. Thus almost anything looks good when measured against 1934. In fact, if we go back five more years to 1929 and use it as a base, we cut the percentage gain to 1947 almost in half, even though the period is longer.

Also, in terms of real output 1947 was a worse year than 1944 - about 13 per cent worse. This may come as a surprise to you because in dollar terms GNP was higher in 1947 than in 1944 and because the civilian part of the economy actually was better off in terms of physical goods and services available. But the big war production year was 1944 and we had a very sharp price rise right after the war. Actually we did not get back to the real amount of output we produced in 1944 until 1951, and that level was influenced in part by the Korean War.

Perhaps the two most important things to note about economic growth records are these. First, the very long-term picture shows an average rate of growth in this country of about 3 per cent per year compounded. This is the record of the whole of the Twentieth Century to date. That rate is equivalent to doubling real output every 25 years. Second, this is an average rate of growth, and growth in any one, two, or several year period may be substantially higher or lower than average. Thus we showed a growth rate of about 8 per cent in 1951, and of about 4 per cent in each of the next two years. In 1954, output was 2 per cent less than in 1953, but in 1955 it expanded by 8 per cent again. Growth in both 1956 and 1957 was below average, and in 1958 output declined. The expected rise in 1959 is well above average. To go back

to my first illustration, 1947 through 1959, the average growth rate is somewhat higher than the 3 per cent long-term trend.

Now this is a lot of figures to cite. I give them to emphasize this major point. Growth does not occur smoothly; its course shows jumps, slips, and levels. There are a number of reasons for this and we now turn to some of them.

Growth involves both the capacity to produce and the capacity to consume. We get physical output of goods and services by applying human brains and muscle to natural resources. As we improve the efficiency of this human energy through better technology and by developing capital, we increase productivity. To develop the capital we have to have saving - deferring consumption today so as to have more tomorrow.

This process simply is not a smooth one. We seem to get our technological improvements in waves; we get changes in the rate of saving and of capital formation; we even get changes in the rate of population growth. We can make some adjustments to compensate for the strong ups and downs of these factors but we cannot, nor do I think we ever will, smooth out the growth curve completely.

Almost by coincidence, productivity or output per man hour, the combined result of improved technology and more and better capital goods, has grown in this country at an annual rate that comes fairly close to equalling the annual growth rate in output. Productivity has increased by about 2 1/2 per cent per year compounded in this century. Like the output curve, the course of productivity shows jumps, slips and levels as we would expect. But the striking point to observe about this factor of productivity is that, given today's technology, we could be producing far more than we are if we wanted to work as hard and as long as we did 50 years ago. What has happened is that we have taken about half of our productivity gains in the form of increased leisure and about half in the form of more output.

And this brings me to the other side of the growth picture - the consumption side. In our form of economy we produce primarily for people - for individuals. Individuals have preferred to take some of the gains in productivity in the form of shorter hours and some in the form of increased supply of goods and services. We are now taking far more in the form of publicly provided services than we used to - in large part in the form of a large defense establishment, but also in many other forms. A good many people believe that we should increase these publicly provided services - partly in a bigger defense establishment and partly in improving education, roads, public health, pensions for the aged, and so on.

But the real point to be made here is that the consumption side of growth is important. It is not enough to have capacity to produce goods and services; we have to have effective demand for these goods and services. While economics teaches us that man's wants are insatiable, it has never taught that man's want for any particular or specific good or service is insatiable. This is as true for public as it is for private goods and services. And this means that we have to have balanced growth in demand to accompany the growth in capacity to produce. If we fail to attain balance or equilibrium, we will find instances where we have too much or too little capacity or too much or too little demand. These instances, as illustrated by behavior over the past three years, produce inflationary tendencies or recession.

One final point about growth needs to be made and it is an important point. The standard of living concept embraces more than mere physical goods and services; it also embraces the concept of enjoyment of those goods and services. This is why we have taken some of the fruits of productivity in the form of increased leisure. And this is why it is difficult to compare growth rates as between countries or over periods of time. The percentage

gain in physical output simply is not the only measure of growth.

I have spent a good deal of time in this general discussion of economic growth because it seems to me important to consider and define before we begin to talk about the proper climate for growth. What I have tried to show so far is that growth is not a smooth process, nor are we likely to make it so; that we can produce more if we want to, but that there has to be some purpose involved; and that we have been doing somewhat better in the whole post World War II period than we have done on the average during the Twentieth Century to date.

Let us turn now to look at the price record over the long term. Again it is necessary to use some figures to make the points clear. If we take the period from 1934 through 1958, we find that wholesale prices have advanced 145 per cent and consumer prices 116 per cent in that 24 years. This same period saw the Gross National Product expand by 186 per cent in constant dollars. About nine-tenths of the wholesale price rise and almost four-fifths of the consumer price rise occurred between 1939 and 1951. This, of course, is the period that saw the defense build-up, World War II and its aftermath, and Korea. Or to turn the example around, only one-tenth of the wholesale price rise and one-fifth of the consumer price rise took place in peacetime, classing the present cold war period as peacetime. In contrast to this, 40 per cent of the gain in real output occurred in peacetime and just 60 per cent in the years 1939-51.

What is even more noteworthy is the fact that roughly one-third of the total wholesale and consumer price rise of the whole period took place between 1944 and 1947 and reflected in large part the repressed inflation of the price control years. During that time real output, as noted earlier, actually dropped by one-eighth. Between 1951 and 1956 real output rose 18 per cent while wholesale prices stayed level and consumer prices increased about 4 1/2 per cent.

Taking a very long look at price trends shows that the rate of increase of both consumer and wholesale prices over the past 60 years has been about 2 1/3 per cent per year compounded. But again it must be remembered that most of the increase came in two World Wars and the Korean War. Even counting in Korea, the rate of price increase at retail since 1948 has been about 1 3/4 per cent per year and at wholesale 1 1/3 per cent per year - about half that for the whole 60-year period. And just to give one more contrast, the rate of price increase way back in the peacetime years, 1897-1913, was 2 1/3 per cent - the average for the whole period.

It seems to me that there is little, if anything, in this record to indicate a causal connection between inflation and growth. Of course, general economic theory and history both lead to the conclusion that inflation tends to work against rather than for growth, and the record is consistent with that conclusion. The evil effects of inflation have been cited so often in recent years that they need be given but brief mention here. The adverse effect on saving, which is required to finance the capital investment on which growth is based; the tendency toward speculation and unwise or unwarranted expansion; the upward push of costs which tends to price goods out of reach of those who do not share equally in the inflation and thus weakens markets; the social inequities of rapid shifts in income patterns: all are well known developments. None of these can be argued logically as being promoters of growth; their actions naturally would seem to inhibit growth. Thus the fact that the record shows occasions when we have had both growth and inflation would seem to indicate at best, coincidence.

The record also seems to show that control of inflation is by no means a hopeless task. Particularly in the period from 1951 through early 1956, when there was substantial growth without appreciable inflation, does the record give encouragement. Actually the whole postwar period from 1948

on looks fairly good, even though there was a Korean War and a major defense program continues still. While I would not attempt to claim undue credit for a flexible monetary policy in contributing to this after 1950, I think it is more than a coincidence that the postwar period of relative stability and relatively high growth has seen the re-emergence of flexible monetary policy.

Perhaps it would be desirable at this point to come a little closer to defining price stability than has been done so far in this talk. Price stability does not mean price rigidity nor does it mean that individual prices should stay constant. Our kind of market economy calls for the price mechanism to allocate resources by reflecting the cross-effects of demand and supply. As changes in particular demands and supplies constantly occur, this allocation process cannot take place unless individual prices have some flexibility. The general level of prices, however, should stay relatively stable. It can register moderate ups and downs over reasonable periods of time without detracting too much from the general beneficence of stability. The key point is that prices should not move rapidly or constantly in either direction. From this it would follow that so-called creeping inflation of 3 per cent per year compounded over a long period of time is ruled out as undesirable, particularly in peacetime. We have a far better record than that in the postwar years, excluding Korea.

One other conclusion may be drawn from the statistical record of price behavior. The experience of the 1944-1947 period seems to invalidate the claims advanced for the efficacy of direct price controls. Memories of the black and gray markets of those days and the price behavior of the post-control period hardly argues that this type of control can cope with basic inflationary forces, even if it were consonant with a free enterprise economy.

I have said that the postwar period as a whole looks fairly good in terms of growth and price stability. So it does relative to much of the rest of this century to date. But two questions immediately come to mind. Is the record good enough? Can it be improved? In other words, do we have or can we attain the proper climate for continued greater growth?

Here it is of high importance for us to keep in mind that we are talking about growth in our kind of political economy with its emphasis on individual freedom. Historically we have placed our dependence upon free choice of work and of the fruits of work to give our economy its dynamic quality. We have depended essentially upon the interplay of demand and supply and the price mechanism to allocate resources and goods and services. This mechanism has some natural imperfections and we have contrived some other interferences, but by and large it has done its job fairly well.

Our kind of system places great value on individual freedom and it requires a high order of individual responsibility to make it work. One big reason why some people view the ostensibly favorable postwar record with pessimism is that they believe they see some decline in the sense of individual responsibility. As a matter of fact, a good many thoughtful Americans recently have been writing and speaking of the need for all of us to reaffirm the moral values that have made this country strong. They call for a re-dedication of individual responsibility and a recognition that our world position requires greater rather than lesser exercise of that responsibility.

There are some areas of American life which require more rethinking of goals and responsibilities and more effort to achieve those goals than do other areas. In the field of economics the course seems reasonably clear and, in a sense, involves no great effort. What it does involve is a clear recognition of economic facts, the exercise of responsibility and intelligence in pursuing economic objectives, and the definite desire to keep these objectives

fairly consistent with each other. To say this in another way, what is required on the part of everyone is to think of tomorrow as well as today when striving for economic gain and to recognize that the course of economic development simply is not likely to be a perfectly smooth process.

Let me translate this into a few specific points of illustration.

Item: We all know that economic growth depends in large part upon growing capital investment and improved technology. These in turn depend largely upon the volume of saving and upon the return on investment. While the motives for saving and investment are complex, one powerful stimulant is rate of return. Thus, in a free economy low interest rates and low profit rates are not unmixed blessings. What we want normally is interest rates low enough to encourage the use of savings but high enough to stimulate an adequate volume of savings. We also want an economic environment that gives reasonable assurance that savings will not be eroded by price inflation. Furthermore, we need profit rates high enough to induce investment but not so high as to create maldistribution of income.

Item: A successful and growing economy produces a high level of employment. But no policy, public or private, can produce a continuing high employment level if the output, public or private, of that employment is produced at costs too high to be absorbed by the people either through private demand or in the form of public demand. Thus wage increases that surpass productivity increases over the long run not only raise costs unduly but limit employment. And the fact that the United States is a highly self-sufficient economy merely means that we have some more room to operate with undue cost increases than many other economies; it does not mean that we can blithely ignore this factor. It has been asserted that we may choose either high

employment or price stability as a major goal; actually we have no such choice. If we have constant cost inflation, we cannot achieve high employment.

[tem: As noted above, goods and services produced have to be absorbed through private or public demand. Easy acceptance of cost increases on the assumption that they can be passed on in the form of price increases quite often leads to rude shocks to the seller because there are natural limits to this process. One limit comes from what economists call "marginal utility"; since price increases are not even, some goods simply get priced out of markets because cheaper substitutes become available. Another limit is income maldistribution that quite often accompanies price inflation and tends to limit markets as a whole. A growing economy needs wider rather than narrower markets; price increases simply do not widen markets.

[tem: No matter how responsibly we act as economic and rational individuals, the economy is likely to get out of balance from time to time. We have learned how to minimize the adverse effects of such imbalance through so-called built-in stabilizers and we have relied on fiscal and monetary policy to act as general economic balance wheels. These balance wheels, however, have to be allowed to operate functionally if they are to serve their purposes. With respect to fiscal policy, this means balance in normally good times, surpluses in inflationary times and deficits in recession. Deficits in normal times are highly undesirable; in inflationary times they are distinctly perverse. With respect to monetary policy, its effects are felt through restricting credit and growth in the money supply in inflationary periods and reversing those actions in deflationary periods. No one criticizes an easy money policy, but there seems to be some lack of understanding that a restrictive policy to be effective has to restrict.

To conclude this talk let me summarize what I have tried to say.

We want a growing economy in this country; in fact, we have to have a growing economy to produce a high level of employment and to produce the volume of goods and services we need for a more abundant life, for an adequate defense establishment and for the host of public services we demand. We have the basis for such an economy, we have the resources and the technology to grow in the future at an even higher rate than in the past. What we need to do is to have the will to grow and to follow policies which will promote rather than inhibit or limit growth.

We must stop talking so much economic nonsense in contending that there are irreconcilable conflicts between the objectives of growth, high employment and price stability. The price of high employment is not inflation; the cost of price stability is not unemployment. Actually the requirement for real growth is high employment and price stability and the requirement for price stability is real growth and high employment. We not only can make these objectives consistent, we have to make them so to provide a proper climate for growth.