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WHAT PRICE GROWTH

Under the heading, "You, Too, Can Play With Numbers," McGraw-Hill economists have worked out a convenient reference table (published in Business Week for May 23), from which you can pick at your pleasure one of 78 different, legitimate growth rates for the postwar U. S. economy. With one of these handy-sized tables in your wallet you can quickly summon such figures as may be needed to down a would-be opponent in argument with evidence that (a) our country hasn't grown as well under your opponent's political party as under yours, or (b) our country's growth rate is slipping behind that of the U.S.S.R. and something ought to be done about it.

While we can all enjoy the fun in which these data are presented, they also have merit in that they illustrate some very important things about growth that we must keep in mind.

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. 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. This is why the table can show so many growth rates. 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, a minus 2 per cent in 1954, and a plus 8 per cent in 1955. Growth in both 1956 and 1957 was below average, while in 1958 output actually declined. The expected rise in 1959 is well above average. Now these are a lot of figures to cite. I give them to emphasize this second major point. Growth does not occur smoothly; its course shows jumps, slips, and levels.

Let's look at this question from another angle. 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 equipment, we increase productivity. To develop the technology and equipment, we have to sacrifice through saving - deferring consumption today so as to have more tomorrow.

This process 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 now, nor do I think we ever will, smooth out the growth curve completely.

Productivity, or output per man hour, is the combined result of improved technology and more and better capital goods. It 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.

One further 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 is in this respect a rather hollow measure of growth. In this country growth only makes sense in terms of the kinds of goods people want and under a maximum of liberty for the individual in choosing the goods he wishes to consume.

I wish now to present the proposition that price stability is an essential requirement for effective and sustained growth, and price inflation hinders it. Price stability does not mean price rigidity nor does it mean that individual prices should stay constant. 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 benefits of stability. The key point is that prices should not move rapidly or constantly in either direction.

One reason why so-called creeping inflation of, say, 3 per cent per year is undesirable is its adverse effect on savings. As identified earlier, one critical element in growth is the introduction of improved technology through capital investment. Savings must remain sufficiently attractive to induce people to withhold enough of their income from consumption today to finance the plant and equipment that will enable us to produce the kinds of goods we will want tomorrow and at prices we are willing and able to pay. Long continued erosion of the dollar's purchasing power becomes a strong deterrent to saving.

Let me turn now to discuss briefly a point on which there seems to be a great deal of misunderstanding - interest rates and their role in a free economy. The subject has come in for considerable attention recently as the President has asked the Congress to remove the present 4 1/4 per cent ceiling on Treasury bond rates and the 3.26 per cent ceiling on Savings bond rates. He also has asked for an upward revision in the Federal debt ceiling and certain technical changes which would facilitate debt management, but these requests are better understood and less controversial.

Speaking broadly, the interest rate is nothing more or less than price, namely the price of borrowed money. As a price, the rate reacts to the same sort of influences as other prices in a free market economy - influences that operate through the demand for and the supply of funds available in credit markets.

On the demand side the principal impact on interest rates in this country reflects the actions of four groups of borrowers: individuals, corporations, state and local governmental units, and the Federal government. The total debt of these borrowers has about doubled in the past twelve years, from approximately $446 billion to about $880 billion. Of this increase in the last twelve years most of it has come from individuals, corporations, and state and local governments. Individual borrowings have jumped from $60 billion to $240 billion; corporate borrowings from $110 billion to $298 billion; state and local governments from $16 billion to $59 billion. The Federal government debt rose only $23 billion, from $260 billion to $283 billion in that same period.

On the supply side funds come from two sources: savings or money creation. From the borrower's point of view it doesn't make any difference from which source he gets his funds, but the difference between the sources is of crucial importance from the standpoint of achieving price stability and sustainable economic growth. I'll say more about that in a minute.

Now there has been a lot of argument among economists about the factors that determine interest rates. But no economist really argues against the demand-supply relationship. The arguments are over what causes the demand factors and the supply factors to change. Certainly lenders like high rates and borrowers like low rates. The real point is what their actions and their expectations do to the demand for and the supply of funds.

Historically, high level economic activity - prosperity - increases the demand for funds. High income and good rates of return stimulate savings. Thus we associate high prosperity and high interest rates. In recession demand is low and even though savings may be large the demand-supply relationship shifts to oversupply and rates tend to be low. Given the high level of demand for funds that has doubled total debt, it is no wonder that rates have moved up in the last twelve years. Given the high level of Federal Government demand to finance a deficit, there is no wonder that rates on Governments have moved higher in the last year.

You will recall that I spoke of two sources of supply - savings and bank credit. The former comes from income and does not increase the supply of money - merely the supply of funds available to lend. A dollar saved is obviously a dollar not spent. The demand for current output of goods and services is not increased in the total.

This is not the case with new bank credit for it does increase the money supply and thus add to the total amount of funds. It is in this area that the Federal Reserve works - its policies lead to more or less new bank credit - new money - additions to the total supply of funds.

Now the Federal Reserve does not favor high rates or low rates. It favors rates low enough to promote adequate borrowing and high enough to promote adequate saving. These rates change with changing conditions in a free market. Unless they change, they cannot measure and equate demand and supply. So the Federal Reserve does not strive for any given level of rates but merely for a

level of bank credit which leads to a given pattern of rates determined by the market.

In a situation like the present, if the Federal Reserve were to promote more bank credit, the supply of funds would increase. For a short time rates might fall. But the money supply would build up and would lead to price increases. This would raise total demand for funds and rates would rise. Again more bank credit would be created, again fund supply would rise, again prices would rise, and again demand for funds would raise rates. This is the familiar inflation spiral. The point is, of course, that you can never catch up.

Now, one last point on interest rates and I will have finished this discussion. Who gets the benefit of higher rates - how much does it raise costs and how much does it add to financial institution revenues and take away from individuals and government.

Well, interest rates are a minor factor in costs. In 1957, for example, interest costs of all manufacturing corporations amounted to .4 of one per cent of sales or $4 on every $1,000 of selling price. That is not very much. Most people do not stop borrowing because rates move up; they stop because the supply of credit is curtailed.

In 1946 our total Federal interest payments were $4.7 billion. Last year they were $7.6 billion or about $3 billion more. Who got this increase? Well, half of it went to Government investment accounts (Social Security, etc.) or to the Federal Reserve which has a very large portfolio. In the former case it went directly to Government and to the people. In the latter case 9/10 went to Government since Federal turns back 90 per cent of its earnings to the Treasury.

A quarter of the difference - $700 million - went to individuals, mostly to holders of Savings bonds. Almost all of the remainder - $800 million - went to businesses, local or state governments, or miscellaneous investors.

Commercial banks collected just $100 million more; mutual savings banks no more, and insurance companies $200 million less. In 1946 these financial

institutions got 45 per cent of Federal interest payments; last year they got 26 per cent.

Well, what was to be a minor digression has turned out to be a major speech. It is important to recognize some of the real facts about interest rates, however. The President's request is not a capricious one - no borrower wants to pay more than he has to. The Government has to compete for funds with other borrowers. It gets rates lower than most borrowers - it always has and probably always will because its credit is good. But it cannot get rates lower than people are willing to lend money.

To get back to my main line, is there any benefit to growth in inflation? A look at the statistical record will, I believe, show no necessary connection between inflation on the one hand and economic growth or high employment on the other. If we take the quarter century 1934 through 1958, we find that wholesale prices have advanced 145 per cent and consumer prices 116 per cent over that period. This same period saw real output, without price change, expand by 186 per cent. About nine-tenths of this 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 the "peacetime" period and just 60 per cent in the years 1939-1951.

It seems to me that there is little if anything in this longer term record to indicate any 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.

As if these were not compelling enough reasons for promoting price stability, a new factor has begun to appear recently on the international scene.

Recent reports suggest that U. S. goods are losing out more and more in world markets as a result of price factors - even in western hemisphere markets which were for so long considered untouchable by European or Orient competition. While evidence on this point is fragmentary, there is some indication that prices of manufactured goods from the U. S. have gone up more rapidly over the past several years than those of such competitors as United Kingdom, Germany, Italy, and Japan. It seems clear that price competition is becoming much more important today and by all signs can be expected to continue to intensify in the future.

Already, because of our growing deficit balance and the new configuration of competitive factors that is emerging, it is becoming clear that we must move toward balance in trade as a national policy. We should not approach such a balance by reducing our imports - we cannot win that game. So, we must as a national objective move toward increasing our exports by all practical means. It becomes a matter of critical concern to prevent the gradual creep of inflation from deteriorating our competitive position in free world markets if we are not to hamper our economic growth through a declining share in world trade.

To take a rather sharp change of pace in this talk for just a moment, we might consider the different sort of interest that we as bankers have in growth viewed on a <u>regional</u> scale. Favorable climate for growth on the national scene is, of course, a desirable prerequisite to healthy state and regional growth. When we get down to examining growth in our region, however, an entirely different set of factors enters and a whole new focus is brought about. Our experience, to be sure, has been one of sharing in the growth of our national economy. Yet when we examine it we also see that our particular region has somewhat different problems from many other regions and as a consequence has not shared equally in the expansion.

Our experience stems largely from two facts. First, agriculture is in the midst of a long-standing technological revolution. In the short period since 1940, crop yields per acre have increased 40 per cent, productivity per animal breeding unit has increased 30 per cent and output per farm worker has more than doubled with the resultant release of population from farm areas to other sectors of the economy. Second, we are the most "agricultural" of all the Federal Reserve districts. About 25 per cent of our people still live on farms and ranches - twice the national average. This means we've got a much larger than average source of supply of people wanting to move from farm to town, and indeed if we were to accommodate all these people within our region, we would have to offer a correspondingly larger-than-average increase in employment opportunities in the non-agricultural sector of our economy.

Yet, in fact, the over-all expansion of markets and manufacturing in the Ninth district has tended to be not larger, but rather somewhat smaller than the national average during the postwar period. Let me illustrate: between the two Censuses of Manufactures of the years 1947 and 1954, the dollar value added by manufacture increased for all industries in the U. S. by 56 per cent, whereas the corresponding increase in the Ninth district was only 48 per cent. Even the district's number one industry, food processing, increased only 28 per cent compared with a national average increase of 32 per cent.

The net result is that the Ninth district as a region has shown a declining share of the nation's population. In 1910, we had 5.7 per cent of all the people in this country. Today we have 3.8 per cent. We have grown in total numbers, but the rest of the country has grown more.

Business and public leaders alike have from time to time expressed concern over one aspect or another of this situation. Might not the establishment of a reputation as a slow-growth region unduly jeopardize our chances to

share in the expansion plans of, say, the larger national corporations?

Then, too, questions have been raised about the significance of lower per capita income here. In 1956, for example, per capita income for the four full district states was $1661, compared to a $1940 national average (the Montana figure was $1862). Are we actually less well off then other sections of the country?

Others pointed to an unwanted side effect of population movements. Because of the greater mobility of younger workers, (those, say, in their 20's and 30's) the age distribution of our region's population has been modified over recent years to give us an increasing proportion of the very young and the very old relative to the national distribution. This tendency for young people, in particular, to migrate out of the district raises various questions. For example, can our states afford to provide higher education for many who will later migrate to other areas? How may economic opportunities in this area be expanded so as to reverse this trend? Further, is such expansion not impeded by the loss of younger, more aggressive members of the labor force?

Community development and area development are concepts that have been given great play in recent years. Considering the problem now from a region-wide standpoint, is there something that might be done by regional study and action to improve our growth picture relative to the rest of the nation? This is a question for which we have no really good answer available at the present time. I would like to point out here that a comprehensive regional study is now getting underway to investigate just that question. While this is not the occasion to go into the details of the program, you will be interested to know that this program, to be carried out under the direction of the non-profit Upper Midwest Research and Development Council, will be of unprecedented sc ope, involving ultimately several hundred thousand

dollars in research effort and will represent something of a pioneering effort in regional cooperative studies.

As leaders in your respective communities, and as practitioners of the profession of banking, I think you are all concerned with the question of growth as it has been here discussed - both on a national scale, with all the serious overtones this carries, and on a regional scale, with its sharply contrasting set of considerations.

Yet these two phases of growth share common bonds. Establishment of proper policies and action with respect to each involves an intelligent evaluation of our goals; it involves an understanding of the nature and function of growth in our economy; and certainly, as my opening illustration would point out, an understanding of the errors and pitfalls in accurately measuring growth. Further, it is clear that "growth for growth's sake" has no place in either the regional or the national picture. While we recognize the desirability of growth, and in fact, its necessity if we are to preserve the ways we cherish, we must never lose sight of our basic framework of freedom; it is individual choice working through the market that is the basic mechanism for effecting the right kind and amount of growth in our society.

The price of growth is not creeping inflation. The price of growth, of real and substantial growth - if it has a "price" - is a proper acceptance of the adjustments that freedom of choice and changing technology inject into our economy and of the restraints that are from ti e to time necessary to prevent self-fueling excesses from acting to the detriment of enduring growth over the long run.