

Commencement Address
Summer Session
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Frederick L. Deming, President
Federal Reserve Bank of Mpls.

THE CHALLENGE OF ECONOMIC GROWTH

Dr. Willey, members of the staff and faculty of the University of Minnesota, graduating students and their guests, I am truly delighted to be afforded the opportunity to appear before you at this 1959 Summer Session Commencement Program. While I am neither a native of Minnesota, nor a long time resident here, I have for many years been aware of the fine reputation which the University of Minnesota and its many distinguished graduates have established for themselves. I am sure the present class will continue that tradition.

I have chosen to talk on the subject, 'The Challenge of Economic Growth.' I have chosen this for two reasons. First, it is an area which the policy decisions of the Federal Reserve System touch and influence and thus it is one with which I am closely concerned personally and professionally. Second, it is a topic that has the sort of forward-looking sweep that would seem to be most suitable for a commencement address.

To set this topic in proper perspective, let me put it this way. The 'Challenge of Economic Growth', with the meanings I shall subsequently impute to it, is only one of a great many problems that face us, yet it is an important one. Each of the many varied disciplines represented by the graduating students here tonight has its own special problems and challenges that perhaps shall be of more consuming day to day importance to each of you as individuals. Yet as we focus our attention for the next few moments more narrowly on the problem of expansion of the material fruits of our economy, we shall be considering a challenge that will substantially alter each of your lives according to decisions yet to be made in response to it, no matter what your calling.

Twenty years ago, on an occasion similar to this, a speaker might well have talked on 'The Challenge of Economic Stagnation'. Today's title represents essentially no change in economic principle or understanding, but more of a change of psychology growing out of the experience of the day. Indeed during the Thirties many economists concerned themselves with the problems of the mature economy - one, that is, which had 'run out' of growth.

I might comment in this regard that analogies were even looked for in the behavior of populations of fruit flies. I suppose many of you, particularly those in the areas of biological sciences, genetics, and statistics, developed a certain familiarity with the ubiquitous genus, Drosophila, and perhaps its most distinguished ambassador to college laboratories (and lunchrooms), D. melanogaster. These have made particular contribution to the social sciences by empirically tracing out growth curves, as follows. Two appropriately selected fruit flies are introduced to a closed bottle. As they become innocently engaged in the pursuit of fruit-fly happiness, they soon discover the buzz of little wings about the bottle. Eventually things become a bit crowded, and the rate of population expansion drops rapidly until, like the economy they presumably shadow, organic expansion has reached the limit of its resources. That sort of experiment was all well and good at the time, but apparently between then and now somebody 'pulled the cork' out of the bottle.

Today a more prevalent notion than stagnation is that 'the sky's the limit' in further growth. As a result a new emphasis has been brought to the problem of economic growth. News headlines, congressional hearings, professional articles and discussions revolve around the question of how we as a nation might best nurture economic growth, and how we might avoid doing things that would stifle it. Even such currently discussed notions

as 'underdeveloped countries', 'underdeveloped areas', and 'regional development' are related concepts. The interest in this question of course, is world wide.

Now let me state essentially my thesis on the challenge of economic growth. I first wish to discuss what I will term the 'internal challenge' and then proceed to discussing an 'external challenge'.

THE INTERNAL CHALLENGE

We look back on many years of unprecedented expansion in material standards of well being, punctuated since 1940 by only minor falterings of our economy. The physical product of our economy has expanded since 1900 at a rate averaging 3 per cent per year compounded, equivalent to a doubling every 25 years. The big concern now is whether we can continue to improve our material standards. And this issue becomes all the more challenging in the light of our rapid population expansion.

One particular aspect of this challenge upon which debate is now centered at the national level may be expressed in the form of a question, and I would like to devote a good share of my remarks to discussing that question. Essentially the question may be stated: are economic growth, price stability and full employment compatible?

Now each of these three things is conceded by most persons to be a desirable condition in itself. We aspire to have growth in real output per person - this is the same thing economically speaking as an improving standard of living. We want to have stable prices to prevent erosion of the value of savings and fixed incomes. We covet full employment because anything less means we have idle productive capacity, and furthermore it is undesirable to have people who want to work sitting around idle.

Debate today centers on the problem of reconciling the three objectives. One school of thought maintains that the three are incompatible. At recent Congressional hearings a number of well-known economists testified to this effect. They take the position that while inflation is undesirable, unemployment cannot be tolerated. In order to maintain our economy 'fully employed', so we might attain our maximum potential rate of growth, an expansion of the money supply must be induced in order to bring spending power to the point where resources (i.e., labor) are fully employed and as a consequence some inflation suffered. This degree of inflation that must be tolerated to achieve full employment, is the price we must pay to achieve our full potential growth. What's more, the rate of inflation required to do this has been said to be slight, say 2 or 3 per cent per year. This order of magnitude has acquired the label, "Creeping Inflation". According to its proponents, Creeping Inflation could be controlled, i.e., not get out of hand.

I would like to take issue with this position. First, I would contend that the effects of inflation are far more dangerous and serious than suggested by the proponents of controlled inflation. One of the biggest difficulties might be illustrated in simplest terms by harking back to our fruit flies. Essentially the thing that 'pulled the cork' to permit expansion was technological advance. A great many of you have trained as scientists and technicians. Your life work will center on wresting new knowledge, new ways and new things from the physical universe. Perhaps you have not been used to thinking of yourselves as "corkpullers", at least in the sense I use it here, but you are the ones to whom we look to release us, in effect, from our confining horizons of any one moment, give us broader bases of expansion, and prevent growing demand for material improvements from being stifled. But, and here's the important thing, a considerable financial investment is required to give substance to these discoveries and improvements and to support

the extensive effort of research with which many of you will be associated. The process of investment, and this applies to all economic systems, requires that some members of the economy go without consuming today - in other words, they must 'save' - such that resources may be available for investment into research and plant construction that will bring greater abundance tomorrow.

Now the whole point is that in a system where freedom of choice prevails, the savings process must be sufficiently attractive to induce people to place their money into savings channels. Inflation, creeping or rampant, erodes the value of savings. Indeed the seductive beauty of the creeping inflation idea is that it seems so slight - just a little at a time won't hurt. But an increase in the price level of only 3 per cent annually would reduce the buying power of the dollar by one-half in less than 25 years. Then you see it makes little sense to abstain from consumption now in order to accumulate 'melting dollars' or claims to them. Furthermore the widespread application of 'escalator' clauses in money contracts adds nothing more than burdensome complications to the economic process, as Finnish experience of recent years well demonstrates.

Logic seems ranged against the arguments of the inflationists. So is the statistical record of the past quarter century, which, I believe, shows no beneficial influence of inflation on growth.

Finally, the most compelling point standing against the arguments of the protagonists of mild inflation is the body of documentation, historical and contemporary, of the evil effects of inflation in countries where inflation becomes in spirit or letter a part of national policy, and of the ultimate soundness of maintaining price stability. To cite but one example, the remarkable recovery of the West German economy during the postwar years has been, in the words of Dr. Wilhelm Vocke, former president of the central bank of the Federal Republic of Germany, "closely linked to the restoration and preservation of a strong and stable monetary unit". He states as the

most important lesson to be learned from the German experience, 'monetary policy, firmly committed to currency stability, not only does not conflict with a high rate of economic growth, but indeed is essential to its achievement.'

This statement concisely summarizes my thesis on that aspect of the challenge of economic growth which I have termed the 'Internal Challenge'. Public policy is yet to be settled on this matter.

THE EXTERNAL CHALLENGE

The second aspect of the challenge of economic growth, which I have termed the 'external challenge', involves essentially competition, real or imagined, with Soviet economic expansion. This challenge, or to cast it more negatively, threat, was most particularly symbolized in the public mind by the launching of the sputniks, but also reinforced by the apparent significant advances in Soviet technology made on a number of other fronts. The hitherto generally unquestioned belief here that our system was superior in efficiency to that of the U.S.S.R. seemed almost to be crumbling in the clamor that followed. Fears were voiced that we were losing out in our race with the Soviets, that our economy was not growing as fast as that of the Soviets.

Now, I submit that this challenge to outdo the Soviet expansion, at least as it is characteristically expressed, is a pseudo-challenge to a large extent basically a matter of lost perspective, and one in which there is danger of losing sight of fundamentals. Proposals are made in all sincerity which would have the effect of modifying our economic system in the direction of the Soviet economy in order that we outdo them at their own game of trying to grow faster or more than we do. May I cite just one example, simply to illustrate this sort of reaction to the Russian challenge.

A group of prominent economists recently came out with the statement 'We reject the notion that that government governs best which governs least'.... They go on to say that, "the U. S. is a rudderless ship drifting on what is at the moment a rising tide of economic activity. Without a firm policy we will descend again into the trough of economic stagnation and retrogression....The Federal Government is our only instrument for guiding the economic destiny of the country." And they go on to propose various Federal actions to make the economy grow 4 to 5 per cent every year. If it is true that our market economy, with its peculiar mix of government regulation and private enterprise, is in fact inferior to one in which a greater degree of state planning exists, then indeed some serious implications follow. I submit, it is not, and I believe a closer look at what it actually means to force a predetermined growth rate, given our traditional degree of political and economic freedom, will show why.

The concept of economic growth in a broader sense must embrace more than merely the physical or dollar units of output per person, but also embrace the notion of enjoyment of those goods and services. Let's see for one thing what we have done in this country with our increased productivity of the past. Productivity, or output per man-hour, thanks to the 'cork pullers'. has grown during this century at an average rate of about 2 1/2 per cent per year, compounded. 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. You see, in this country, growth makes sense only in terms of the kinds of goods people want and under a maximum of liberty for the individual in choosing the goods and services he wishes to consume, including leisure. Clearly if it were merely a matter of amassing totals to

'show up' the Soviet economy, we could run the volume of our output to enormous levels.

But if we wish to preserve a maximum of liberty for the individual to choose the things he wishes to consume, then we must also grant him the freedom to change his mind from time to time about how much and what kinds of goods he wishes to buy. The same, of course, holds true for 'community' purchases by the various governmental and public units. The effects of these must necessarily be felt in the outputs of the various industries, and from time to time cause idling of resources or shifting of resources from one industry to another with attendant rises in transitory unemployment. You can guarantee steady expansion of employment in a particular industry only at the price of cutting down consumers' freedom to choose the goods they want, and at the risk of ultimately reducing technological efficiency. So again it is not sheer growth in our system that is important, however significant this may appear in the Soviet economy, but expansion in the kinds and amounts of goods that people by their own choice want to buy. In addition, not only are consumer choices subject to fluctuations but so is the rate of introduction of new technology, capital goods demand in kind and amount, population, etc.

There is little disagreement that it should be public policy to use Federal monetary and fiscal action to the maximum extent possible to minimize the magnitude of such fluctuations, as are an inherent part of our sort of economy, and to take other appropriate measures to alleviate personal and social hardships resulting from involuntary unemployment. Certainly over the last fifteen years, such policies have met with promising success. But the question at issue today goes far beyond that. And here, in my opinion, some of the current reaction to the external challenge comes dangerously close to substitution for our traditional objective of promoting

maximum individual freedom, the general objective of attaining certain collective heights of production.

We should not confuse growth in national accounting totals with more fundamental objectives of this society - and this I would submit is that of providing abundance within a framework of individual liberty. What is required is an intelligent, balanced understanding of the nature and function of growth in our economy. Further it is clear that 'growth for growth's sake' has no place in our national consciousness. While we recognize the desirability of growth to provide better standards of living for an expanding population, 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 nation.

So the essential challenge of growth - one which I commend for your careful study and reflection - is the challenge of creating a proper climate for an expanding real output, yet carried on within a framework of maximum individual freedom. The challenge of economic growth is therefore one involving very basic goals and objectives of our society and one that will be largely shaped through governmental policies in which you as individual citizens will have a voice. It is not a policy that will be decided tomorrow or this year, but will probably be tested and contested over the decades to come. Your individual attention to the Challenge of Economic Growth and your contribution of opinion about it is needed.

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THE END