THE POTENTIAL OF THE AMERICAN ECONOMY

5 February 1962

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NOTICE

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Mr. Leon H. Keyserling, Consulting Economist, was born in Charleston, S.C., on 22 January 1908. He has been awarded the following degrees: A.B., Columbia University, 1928; LL.B., Harvard, 1931. During 1932-33 he was an assistant in the Department of Economics at Columbia. He became an attorney in the Agricultural Adjustment Administration in 1933, and from 1933-37 served as secretary and legislative assistant to the late Senator Robert F. Wagner. From 1938-42 he served successively as general counsel, deputy administrator, and acting administrator, U.S. Housing Authority; and from 1942-46 he was general counsel, National Housing Agency. In 1946 he was appointed vice chairman, Council of Economic Advisers under the Employment Act of 1948, and from 1950-53 he was chairman of the Council. He is presently the president of the Conference on Economic Progress. He is the author of various monographs, articles, and essays on full employment, economic stability, housing and related subjects, and a contributor to "Saving American Capitalism," 1948. He won second prize in the 1944 Pabst Postwar Employment Awards for his essay, "The American Economic Goal: A Practical Start Toward Postwar Full Employment." He is a member of Phi Beta Kappa and is the founder and president of the Conference on Economic Progress. This is his eighth lecture at the College.

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CAPTAIN HARROLD: Admiral Rose, General Quill, Gentlemen: This morning we start our second week of the unit concerned with economic stabilization. Many of the comments and much of the discussion concerning economic matters are related to the various facets of economic disequilibrium.

Our speaker this morning will treat those aspects of economic stabilization which pertain to economic growth. We are fortunate to have with us an old friend of the Industrial College, Mr. Leon H. Keyserling.

Mr. Keyserling was Chairman of the Council of Economic Advisers under President Truman. Presently he is President of the Congress on Economic Progress and is a recognized authority in the very complicated field of economics. He will speak to us today on "The Potential of the American Economy."

Mr. Keyserling, it is a great pleasure to welcome you back to this platform for the eighth time and to introduce you to the Class of 1962.

MR. KEYSERLING: First of all, I want to thank whoever may be responsible for the cordiality involved in having me back here so many times. I have never quite known the reason. I don't know whether it is because an audience has the fortitude to get used to anything, or whether it is because you feel that you can't teach an old dog new tricks. But I think that beyond this, it represents an appreciation, not necessarily that I am right, but that at least that I say what I think, which is valuable.

When we talk about the potential of the American economy, we must realize that, just as the potentials of a man are not really measurable

exactly, and depend upon not only his height and his weight but also upon his education, his training, his attitudes, his sensitivity, the environment in which he lives, and many other imponderables, and even accidents, this must be even more true of a great economy of more than 180 million people which has so many factors in it.

The American economy has no one potential. We learned in wartime that, even with 15 million of our most effective producers withdrawn from the productive processes and brought into the Armed Forces, where they served another useful purpose if not an economic purpose, our economy grew by 9 percent a year, which was about twice what we think of as the optimum potential in relative peacetime, and, as we all know, almost four times as fast as we have been going in the years since 1953.

So it might be said, within reasonable bounds--and those bounds exceed what we have actually done--the potential of the American economy is whatever we want to make it, and how firmly we rise to the challenge of domestic needs and worldwide competition. We can grow at almost any reasonable rate we want to. But we want to grow at a rate which maintains other values--the values of not being under too many forced pressures at any one time, the values of not having so much centralization that we lose some of the flexibility and what we call freedom in an economic sense.

So there are many choices and many values involved in this problem of economic growth. But anyhow, let me set down a few theorems. In the first place, let us say that economic growth is growth in our total national product, or gross national product, as the economists call it--the total output of goods and services used for all purposes. Let us say, second, that how it is used is quite as important as how much it grows. The obvious example is that our gross national product can grow at a very satisfactory rate, but, if we use too large a part of it for tinsel and gloss, we can become like Carthage, of which I have been reading the history again, which gilded the roofs of its houses with gold and wouldn't allow any elephants to Hannibal, and was ultimately so destroyed that nobody knows even what the exact site of the city was.

In the next place we have to realize, what is even more important and what is far less stressed by many economists, not only that growth is important according to how we use the product, but also that how we use the product affects the amount of growth. This is the problem of economic equilibrium, to which allusion was made in the generous

introduction I received. Basically, if we use our economy in the wrong way, it does not grow as well nor as fast as it should. The great problem of economic equilibrium boils down to a simple proposition--the relationship between the amount of our resources that we put into the instruments of production and the amount of our resources that we put into what I call the ultimate demands for products, the ultimate demands for products being both private and public, being represented privately by the spending of the American family, by all the things that it buys and uses, and being represented publicly by what governments do, whether for education or national defense or roads or anything else that governments exercise demands for. Sometimes the government outlays are called investments, but I think this is a little confusing, because the Government, mainly speaking, does not invest in productive facilities, except in rare instances.

I think the simplest method of classification is to talk about investment in the means of production on the one hand and demand for ultimate products, both private and public, on the other hand. If the investment grows too fast relative to the ultimate demand, we get a low and unsatisfactory rate of growth, because we get unused plant capacity in great volume and unused labor force in great volume, and this causes deliberate cutbacks which turn the economy downward. If the demand for ultimate products grows too fast relative to the investment in productive capacity, we get inflation rather than growth--the classic type of inflation; too much money chasing too few goods--because the demand can translate itself only into bidding up the price rather than into effective servicing because the plant capacity isn't there to meet the so-called demand. This is the central problem of economic equilibrium.

What are our potentials of growth, subject, of course, to the reservation I made that there is no one fixed figure? I'll give you a rather simple formula which suits most purposes. Basically, our potential for growth is based upon two things: First, the growth in the labor force, that is, people available for employment. This isn't only employment in overalls or employment in white shirts. It's the total number of people gainfully employed on the farm as well as in the factory, in managerial capacities as well as in work capacities--it's all work, but you know what I mean--people employed for salaries as well as for wages, and even people employed for income which they earn themselves.

The growth in the labor force potentially is about 1 to 1.75 percent a year, depending upon the birth rate in the preceding period, say, 18 to 20 years ago. But, while the potential growth of the labor force is within a relatively narrow range, the actual growth in the labor force depends much more than we usually think--and I believe that this is one of the great oversights in economic thinking--it depends greatly upon the economic environment.

To take the very simplest example, to which I'll refer again later, the labor force in January 1962 was about 100,000 lower than in January 1961. The labor force in December 1961 was the same as in December 1960, when it should have grown by more than a million, because the economic environment was operating to discourage people from entering the labor force, and to prompt people to withdraw from the labor force. The labor force doesn't include everybody who is able to work and willing to work. The labor force is merely the measure of the people who either are working or are actively looking for jobs. So that when you become discouraged and stop looking for a job, or when you don't enter the labor force, you are not counted as in it.

Now, the second factor in economic growth is productivity, or output per man-hour worked. There are measures of productivity not only for the person working in the factory and on the farm but also in the office. There is also a measure of productivity, although it is hard to make, of people working in the public service.

I say, for purposes of rough approximation, that our productivity potential growth rate is somewhere between 3 and 4 percent a year, in other words, that under conditions of reasonably full utilization, output per man-hour will grow somewhere between 3 and 4 percent a year. But productivity is also affected by the economic environment. It's not an automatic technological thing, and I'll come to that in a minute.

So, if you add up the growth in the labor force potential and the growth in the productivity potential, you have an effective normal, current, contemporaneous growth potential in the total national product somewhere between 4 and 5.75 percent a year, which you will note is very much lower than the forced growth rate of about 9 percent that we had in wartime but very much higher than the growth rate that we have been getting since 1953.

Now, what has been the actual growth rate since the end of the Korean war, since the time when we were relieved, if you want to put it that way, of all the pressures which, during a period of war, even limited war, conspire to make us try harder to grow? I use that phraseology advisedly. I'll have something to say about that a little later.

Since the end of the Korean war in early 1953, or during the past nine years, although we have been confronted by world circumstances where we are told, and told well, that the real challenges confronting us and the real need for high economic growth are very urgent, we've grown only about 2.5 percent a year on the average during these nine years.

One point which it is very important to recognize is that this 2.5-percent growth has not been the product of the actual growth in the labor force and the actual growth of productivity. Let's take a very simple example. I'll just use round numbers to simplify the equation. Suppose the labor force grew by 1 percent a year and productivity grew by 1.5 percent a year. This would average the 2.5-percent average economic growth rate. But, if this was what had actually been happening to the labor force and productivity, the actual economic growth rate of 2.5 percent a year would have utilized the annual increase in the labor force and in productivity and, therefore, a 2.5-percent growth rate would not have yielded a long-term, chronic increase of serious size in unused plant and manpower. This is really obvious, and the only reason I mention the obvious is that it is so frequently neglected.

The fact that the 2.5 average annual economic growth rate has yielded over the years since 1953 a chronically rising level of unemployed manpower means, very simply, that the growth rate in the labor force and in productivity, even while too low, even while adversely affected by the bad economic climate, has nonetheless been much larger than the growth in gross national product.

This is very important to realize when we come to the matter of policy and when we come to the matter of what to do about it. In other words, my basic point is that we do not have a labor force problem, fundamentally. We do not have a productivity problem, fundamentally. We have fundamentally a problem of economic equilibrium or of economic policy, namely, to keep our plant and manpower reasonably fully employed. If we do so, both the labor force and productivity will grow in a very rewarding way.

Now, the matter of productivity is so important, and is currently leading to so many deficiencies in policy at the highest levels, that I want to say a little more about productivity. I want to give you just a few figures. From 1910 to 1920, our productivity grew at the rate of a half percent a year. These are averages. From 1920 to 1930, it grew at the rate of 2.5 percent a year. From 1930 to 1940, it grew at the rate of a little more than 2.5 percent a year. From 1940 to 1950, it grew at the rate of 3 percent a year. From 1950 to 1955, it grew at the rate of 3.8 percent a year, or almost 4 percent.

Then we got into a period of severe economic slack, in other words, a 2.5 percent economic growth rate in the overall, with rising levels of unemployed plant and manpower, and the productivity growth rate from 1955 to 1960, when the utilization of plant and manpower was very slack, fell to about 2 percent a year. But from the first to the fourth quarter of 1961, when we were in a period of economic upturn, the annual growth rate of productivity has risen to about 4 percent a year.

The reason I stress these figures is this: When the economist says that the very long-term average of the productivity growth rate has been about 2.5 percent a year, which these figures that I have given you since 1910 lead to, it is just as irrelevant to our current and foreseeable situation as if we tried to measure the recent or current rate of potential increase in military weaponry by figuring out the average increase, if one could do so, since 1912, or two years before World War I. In other words, the long-range trend in productivity--and this is both the challenge and the potential of the American economy--has been to grow at a rapidly accelerating rate during periods when productivity has had the challenge of reasonably full utilization of productive power in-being, in other words, when there is a hand seeking to draw the sword forth from the scabbard. This is important to the problem of economic growth because it again emphasizes that we shouldn't direct our attention primarily toward the problem of productivity itself but primarily toward the problem of utilization as a galvanizing force.

Now, regarding our very low rate of economic growth which, during the period since 1953, it has led to a chronically rising idleness of plant and manpower. By this, I don't mean that this idleness rose every year. If you will visualize a rising 2.5 percent line, you will note that the economy moved up and down in a succession of booms, stagnations, and recessions along that 2.5 percent line, instead of moving upward and downward along a 4.5 percent or 5 percent line, which would have made reasonably full use of our productive powers in being and therefore

would also have provided a stimulus to the more rapid expansion of these productive powers.

As the economy moved upward and downward along this 2.5 percent line, naturally there was a little bit more employment and a little bit more production when the economy happened to be moving upward toward its crest than when it was moving downward toward its trough. This is obvious.

All I mean when I say that there has been a chronic increase in idle plant and manpower is that in the longer run, at the peak of each boom, idleness of plant and manpower was much higher than at the peak of the previous boom. At the trough of each recession, idleness of plant and manpower was much higher than it was at the trough of each previous recession. In 1962, after about a year of recovery, when we have moved a long way toward what most forecasters believe will be the peak of this particular recovery, idleness of plant and manpower is very much higher than it was after a year of any previous recovery since World War II.

To state this in another way, despite the glowing claims that this recovery is more powerful and stronger and more reassuring than previous recoveries, it is really the weakest recovery since World War II. Of course production is higher. Of course employment is higher. We have a bigger economy and par for the course is higher.

But, if we measure it in two absolutely fundamental ways, if we measure it first by how much idleness has been reduced from the trough of the recession in early 1961 to the current situation one year later--and in this I include both plant and manpower--we find that the reduction on a percentage basis has been only about one-third as fast, or, to put it another way, three times as slow, as during any previous recovery after any of the previous three recessions since the end of World War II. If we measure it the second way, by how far we now are from reasonably full utilization of our resources, we find that the gap--the gap which may be expressed in gross national product, the gap which may be expressed in unused plant capacity, the gap which may be expressed in unemployed manpower--is very much larger than after a year of any previous recovery since World War II.

This leads me to the conclusion that, while we happen to be, fortuitously, in an upturn, just as we were in 1959, just as we were in 1956, just as we were in 1950, my observation is that we are still in the

course of a long-term retreat from full employment and full production, paying the cost, therefore, have done almost nothing to date as a nation to deal with the fundamentals underlying the situation. We face the prospect, over the next five years, of averaging no higher a rate of economic growth than we have over the past nine years, in which event unemployment, instead of being in the neighborhood of 6 percent of the labor force, would be 8 or 9 or 10 percent, and unused plant, instead of being in the neighborhood of 10 percent, as best one can measure it, might well be in the neighborhood of 15 percent or higher.

Just as we have lost more than $340 billion of potential production (1960 dollars) and just as we have lost 22.5 million man-years of employment opportunity over the past nine years by this growing disuse of our growth potentials, and by the low growth rate, I think we are in a posture to do so again.

Lest I should seem to be extremist or venturesome, I would like to call attention to the fact, not by way of personal pride, but I think this issue is so important that we shouldn't let false modesty stand in the way of bringing the facts home to the public, that in 1954 I published a volume in which I projected that the growth rate of the American economy during the period from 1953 to 1960 would be only 2.5 percent, and I got it right to the tenth of a percent. Getting it right to the tenth of a percent was an accident, but it wasn't an accident that I came close to getting it right because the fundamental problem was as I saw it. I also computed how much idleness of plant and manpower would rise in the long run due to the slow growth rate, and that also turned out to be nearly correct, which shows that the growth rate of 4.2 percent which I used as representing our potential was not too high, because the difference between the 4.2 percent and the 2.5 percent was used to develop my estimate of idle plant and manpower, which turned out to be approximately correct.

Now, coming to the problem of what the cause of our low growth rate is, the cause is intimated in the basic comment that I made earlier about the lack of economic equilibrium. This lack of economic equilibrium has manifested itself in practically the same way that it manifested itself in the 1920's though in a lower degree, in practically the same way that it has manifested itself throughout the 20th century in the American economy in every period except wartime or rapid mobilization--I am not referring to the fairly constant level of mobilization relative to the size of the economy that we have had since 1953. In periods of wartime, and

rapid demobilization, we have had problems of an altogether different kind from those we have had during the past nine years.

What has happened in the American economy in the last nine years is not novel. It is similar to what happened in the twenties and in other periods, namely, to state it in a capsule, our investment in the means of production, during the boom periods within the cycle, tended to advance much faster than the demand for ultimate products. If we examine the boom periods since 1953 which contained the seeds of their own downfall and therefore resulted in the 2.5 percent growth rate in the long run--for example, from 1954 to 1955, after the 1953-1954 recession, the gross national product grew at the rate of 8 percent a year, which was very high; but the next year, from 1955 to 1956, the growth was 2 percent, which I call a stagnation rate; from 1956 to 1957, the growth was less than 2 percent; from 1957 to 1958, we were in another recession, when we went down 1.6 percent; and then from 1958 to 1959 we had another very rapid advance at almost 7 percent; and then we got into a stagnation and recession again--all of this has reflected a remarkably consistent pattern.

The basic understanding of how this happened consists in analyzing the fevers which preceded the relapses. In other words, if we could reduce or extirpate the fevers, we would not have the relapses, and if we could stabilize the booms, we'd have a better record. Stabilizing the booms does not mean standing still. It means growing. What the economists call a sustainable rate is based upon this equilibrium between investment in the means of production and ultimate demand, to which I have already referred.

Now let us get to the analysis of the character of the disequilibriums which appeared in each of these booms. I have already intimated what they were. They were that investment in plant and equipment grew much faster than ultimate demand. Just to cite a few figures, 1954 to 1956 was a boom period preceding the 1957 recession. During this period, investment grew about four times as fast as the ultimate demand for products. During 1958-1960, which was another boom period preceding a relapse, investment again grew almost four times as fast as the demand for ultimate products. And this investment is gross private investment, which includes housing and inventories and all kinds of other things. If we take that segment of investment which is limited to producers' facilities, in other words, the things which really make our productive power--plant, equipment, and nonresidential

construction--they grew in these periods not about four times as fast but about eight times as fast as ultimate demand.

As the business managers saw--and I am not criticizing them--that their ebullient investments got more and more out of line with the ability to distribute the products they could make, as they saw their excess plant capacity rising, as they saw the outlook for the expansion of ultimate demand not offering any prospect of using what they could make, much less what they would make if they continued their rate of investment, they cut back very, very sharply on investment. This cutback in investment, of course, caused more idle plant and manpower, and sparked economic recession, and this in turn had multiple effects throughout the economy in that it reduced the level of ultimate demand.

Some economists in looking at this say that it is perfectly obvious that these downturns have been caused by cutbacks in investment, and that therefore we can maintain the economy at a higher rate of economic growth if we give stimulus to investment. This to my mind is very much like saying that if a man drinks and eats too much for six months and then lands in the hospital and is put on a very strict diet, and then you observe that if you take the average for the time he was in the hospital and out of the hospital he may have been eating and drinking too little, that therefore the solution consists in encouraging him to eat and drink more before he gets to the hospital. There is a little bit of a fallacy in the line of reasoning, I think.

At the same time, let me point out that I am not hostile to business investment. For the nine-year period as a whole, business investment growth, according to my analysis, was much too low. It should have been much higher, but it should have been higher in an economy growing at a better than 4-percent growth rate, not in an economy averaging 2.5 percent. In other words, if we had maintained the economic equilibrium so that we could have sustained a better than 4-percent growth rate, instead of moving up to 8 and then downward and sideways, the average investment growth rate over the whole period would have been about $10 billion a year higher than it actually was, and therefore we would have had more investment, we would have had more business profits, we would have had a higher rate of technological growth, which depends in part on investment, although as I said before it depends also upon utilization. In other words, through balance within the economy, we would have had a smoother economic performance and a better average in the long run, and we would not have lost the $340-odd billion in production and the 22.5 million man-years of employment opportunity during this period.

This of course translates into every phase of human endeavor. It translates not only into private consumption, it translates into what we can afford for national defense, what we can afford for education, what we can afford for roads and houses, and certainly so when we try to keep public budgetary outlays reasonably close to the amount of taxation which is being raised at any given level of national activity. In other words, if the economy had grown at better than 4 percent a year rather than at about 2.5 percent, we would have had about $90 billion more of public revenues at existing tax rates and we could have deployed that in any way that we chose as a sensible nation. We could have used part of it for tax reduction, which would have been good. We could have used half of it or more for increased public outlays and could have still kept these public outlays at a lower ratio to our total national economy than they in effect were, and we could have avoided the budgetary deficits that we repeatedly had, because the budget of government and the outlays and receipts of government are really a facet, an internal, imbedded facet, of the operation of the national economy.

While during these boom periods the level of investment tended to get too high, the level of private and public consumption was held too low. I am not going into a full description of why this happened. It would take too long. But, broadly speaking, it happened this way: On the public side, it's very simple. The public demand was held too low because the public decided, through its Government, to do too little. A great part of this was at the Federal level, because the States and localities, as we all know, were increasing their expenditures and their debts and their borrowings at a really fantastic rate relative to their potential resources. I won't say more about that at this point. I am not arguing for Federal deficits. We stumbled into a $12-million deficit in one year because we planned a surplus too rapidly. We are doing that again. I'll say a bit more about that later.

The reason that private consumption grew too slowly was twofold First, the public programs which vitally affect private consumption and the living standards of the American people were expanded much too slowly in terms of the new technology, not in terms of a goody-goody wish to help people, although I do think that an economy as powerful as the American economy should give a little more help to the one-fifth of our families which still have incomes of less than $4,000 a year, and a little more help to the 17 million people who are 65 and older, millions of whom have from all sources incomes of less than $1,000 a year. I think they could use more help. I think our economy would be better off if they were higher level consumers.

But let's put that aside. I am talking merely from the functional viewpoint of the operation of the economy. Even assuming that we had lifted our public outlays to what might have been a more generous recognition of the needs of national defense, of our international economic problems, of our education, of our resource development--and I am not talking about inefficiency, because you can spend $50 billion inefficiently as easily as $60 billion, this is an entirely separate question--even if we had done this on the public side, we would still, because of the raging technology, have had a tremendous job of lifting our private consumption in order to keep the wheels turning and therefore providing in a democracy both the carrot and the stick, whereby you obtain public popular democratic assents for the things you want to do publicly as a nation, including national defense and everything else. So the second reason why private consumption grew too slowly was that, in the private economy, consumer incomes grew too slowly.

In other words, an economy which is technologically as strong as ours, and which is spawning a high rate of private unemployment and low income at the same time that it is imposing heavy taxes, is not in a very good posture to get the public assents from the people needed to maintain our public outlays, including our national defense, at the levels which might be needed on other grounds. You can't squeeze blood out of a turnip.

The American people would be perfectly ready and willing, if our current plants were fully used, if there were any prospect of their being fully used, if we had full employment, to bear whatever level of taxation, whatever level of sacrifice, might be needed to do the things we need to do as a nation and which are more important than private automobiles and tail fins and all the other things we talk about. But they are not willing, they do not understand, they do not comprehend why we can't afford, out of our real wealth and productive power, to do these other things without taking too large a share of their income through taxation when we have so much unused plant and manpower, because the American people understand better than some economists and better than some people in government that the real source of wealth in any nation is its power to produce.

Now let us look at the programs of the Government, and let us see where they are getting us toward getting America on the move again, toward getting a reconstruction in our basic thought and action in the direction of what we need to do. I am not here on a political basis.

I am not here as a Democrat or a Republican. I never have been. Some of you may have thought I was when I was here six or seven times during the Eisenhower Administration. If anybody thought that, they are going quickly to find out differently.

I think it very important that there be a few economists in the United States, a few people in the United States, who are willing to rise to a responsibility above rationalization of whatever is being done because it is being done "by my side." This is not a football game. This is a great contest in which the 180 million people of the United States and the people of the whole free world are involved. And somebody has to get off and not think whether he is on the Big Green Team or the Big Blue Team, but instead look at both teams to see whether either of them is doing anything more than just playing a football game.

What must we do? It is not enough to say: "Now that we are in an economic recovery we are up again." This is pretty much the same as a man out in the water whose head is bobbing up and down, and every time his head comes up the people on the dock, instead of throwing him a life preserver, say, "He's up again." This latest "up again" is no different from the earlier "up agains" and I am not going to labor that point, because I have already made it. It's a fundamental misreading of what our problem is. This is a long-term, serious, chronic problem which requires greater sustained efforts by the American people for its solution.

The second basic approach is not to say, "We need to do vigorous things later on." In fact, in January 1961 it was said that if the situation didn't improve a great deal by March vigorous things were going to be done in March. In March the situation hadn't improved, so vigorous things were going to be done in June. Now we are in February 1962 with no really fundamental improvement of the situation, and there are requests for standby powers for what we are going to do when the next recession comes along. There are now requests for standby powers to execute public works and execute reductions in taxes when the next recession comes along.

I'm not against this as a small facet of an overall program, but it is a complete misstatement of emphasis. It's a misstatement of emphasis not only because we are not out of the woods, but also for the more fundamental reason that we should have learned from World War II and we should have learned from all the great experience in the economies

of the world during the last 20 years that we need a long-range, sustained, full prosperity program, budgeting as we go along to maintain the equilibrium, and not merely using counter-cyclical devices to turn the water on the house once it starts burning.

This is the most fundamental lesson that we can learn from what happened here during the war and the great miracles we performed, and also from the fact that our economy, while not doing well, is doing so much better than it did 20 or 30 years ago. We have made some gains, not primarily because of the reactive devices, not because of the fire engines, although we need them, but primarily because there has been built into the structure of the economy forces which maintain a better equilibrium and a better movement forward than we had a generation ago.

It is a terrible thing, when we have to face in the totalitarian competition such an extreme example of forward planning, that we are doing so little of it under the methods of freedom. Let me say that I have never believed it to be patriotic to tell the American people that the Soviets couldn't do this and couldn't do that. We heard they couldn't have atomic energy, they couldn't have a science because they were not a free people. Now we hear they are in a huge agricultural mess, and that they are not going to do this and they are not going to do that.

I'm not overimpressed by what they could do or can do. I don't think they have the intrinsic strength that a free society has, but I think they are going to do plenty. I think that when you match that with what the people of China, who will soon be a billion people, are going to do over the next 10 years, we've got a problem. And we are not wise when we say that the problem doesn't exist.

I think that, when we see that kind of positive planning, and when we see the countries of the Common Market moving forward and registering a very much higher growth rate than we are, catching up on many fronts--and I am not going, unless you ask me in the question period, into all the arrant nonsense we have gotten into in the discussion of the balance of payments problem--it is to my mind a serious thing that we in the American economy under a free system are not doing the kind of equilibrium planning toward a balanced appraisal of our resources and how we need to use them, and moving forward on a positive program.

Let me say that the 6-percent unemployment figure is really a vast underestimate. It doesn't take account of the full-time equivalent of part-time employment. It doesn't take account of the fantastic fact that during the past year our labor force hasn't grown at all, when we were hearing a year ago that one of the reasons why we needed so much more employment was because of the high birth rate after World War II and that the labor force was going to grow at an exceptionally fast rate. What does the fact that it hasn't grown at all mean? It means either that there is something wrong with the statistics, which I don't want to imply, or it means that the problem is temporarily being swept under the rug by the disutilization of millions of people who technically are not in the labor force but nonetheless are potential workers. You can't sweep this problem under the rug indefinitely. The way technology is moving now, this idle plant and manpower is going to reburst forth with volcanic proportions within a few years unless we get the growth rate up.

Now, in addition to the standbys, the essential, basic element in the current program to deal with the situation is the 8-percent tax-credit proposal. This proposal is advanced to provide stimuli to new investment, on the theory that business investment means productivity, that with a higher rate of productivity growth we can have more economic growth, and that, therefore, if we provide an 8-percent stimulus to business investment, we will get a higher rate of economic growth and a higher rate of productivity growth. This is why I placed so much emphasis upon this earlier in my discussion.

This would be true if we were operating at full use of our resources and therefore had to provide this kind of incentive to get a faster rate of technological growth, but then we would have to provide equal incentives to a higher rate of demand for ultimate products. Where these analysts fall into their great fallacy is in not realizing that the ratio of business investment in productive facilities to ultimate demand has nothing to do with the rate of growth that you want. In other words, this ratio, if it is going to be sustainable, is determined by how many dollars of investment create how many dollars of product. If a 10-percent increase in investment under the new technology results in productive capacities that increase 20 percent, which I think is likely, then you have to have a 20-percent increase in ultimate demand to maintain equilibrium, whether you want a 4-percent overall growth rate, or 6 percent, or 8 percent or 10 percent.

When we recognize this, the whole analysis that we are just going to put more money into stimulating plant and equipment and therefore get more growth breaks down. What it is actually going to do is spend itself in futility while we have as much unused plant and equipment as we now have, because the business managers are sensible enough not to expedite their plant facilities much merely because they get an 8 percent bonanza. In the longer run, circa 1963-1964, it will accelerate the very kind of disequilibrium which the same kind of tax bonanzas accelerated in 1957, when I was trying so hard to stop them, and when the Chairman of the Federal Reserve Board and the Secretary of the Treasury were going up on the Hill and saying, "We've got to stimulate investment," and I said, "You've got excess capacity everywhere," and they said, "No, we need more savings and more investment." The Committee challenged them, and after a week of inquiry, as you may recall, the only thing they could find out we were short on was one very particular kind of lead pipe. It was really laughable if it hadn't been so serious.

Why, as a nation, with this experience so crystal clear, with the potentials to be gained from empirical observation so blatantly obvious before us, do we restart the circle, fight the last war, make exactly the same kind of mistakes we have been making all along and add to the economic disequilibrium?

Finally, the Federal budget and the monetary policy are another example of this. I detected in the campaign of 1960, and I am not talking politics, a true understanding that we needed a more liberal monetary policy and a more liberal budgetary policy, not to unbalance the Federal budget but to balance it by balancing the national economy.

What do we have today? We don't have a proposed fiscal 1963 budget designed to run a surplus of only half a billion dollars. When you look at the real budget and its impact upon the economy, we have a budget that proposes to run a cash surplus of almost $3 billion, and to run a surplus in the Government accounts of $4.4 billion, at a time when the economic advisers of the President themselves are saying that we want to use the budget as a modern tool to stabilize the economy, and when their own projections of where we will be a year from now contain acceptance of a very high level of economic slack. In other words, the same document which indicts the Eisenhower administration for tightening up precipitately on the budget and thus choking off and aborting the 1959-1960 economic recovery contains facsimile evidence that the new budget is trying to do exactly the same thing.

oney policy? The same thing. We still have a trend toward
erest rates, a continuous clamping down of the monetary
elow the levels required for economic growth. This doesn't
sent deliberate aberration. This represents the fact that, in the
erican economy and in the American structure of government, we
ave not developed at any responsible topside level the kind of quantita-
tive analysis, the kind of quantitative planning, the kind of establish-
ment of goals, the kind of examination of interrelationships, the kind
of dedication to a national purpose, which are the first requirement of
orderly action in these times, which are the expressed statutory man-
date of the Employment Act of 1956, and which are a great worldwide
imperative in the kind of world we are living in.

We hear the reams of debate, the millions of words of discussion
of the great national purpose, but we don't have it. We have a set of
economic programs and a set of economic policies, each determined in
splendid isolation at some point in the Government, based on inertia,
based on conventional thinking, based on the pressure of interest
groups, but we have no confluence, we have no plan. I am not ashamed
of the word, "plan." I am not talking about the planning. I am talking
about the fact that the American people and the American Government
cannot continue in those basic national policies which are shaping our
destiny to fly quite as blind and quite as reckless as we always seem
determined to do, except when we are in a shooting war.

I don't happen to believe that history has placed some kind of
benign protection over the United States of America so that we will
always be able to work our way out of difficulties if and when we get
into a shooting war. I don't think the next shooting war, if there is
going to be one, is going to be of that kind. I also think that the last
best hope for avoiding one, in the whole context of opinion all over the
world, is to build the kind of strong, purposeful, fully employed
America that we talk about and that the world looks to.

The most serious thing about the amount of idle plant and manpower
that we have is not the economic loss but the picture it gives to the
whole world of America being the one--and I say this advisedly--modern
industrialized nation that during the past decade has been willing, as an
economic and as a human matter, to tolerate, and even to extenuate,
this amount of wastage of its own resources, and both its economic a
its social implications.

So I think we need some limited portion of the kind of national economic planning that we had during World War II. I think it is a great injury to the American people to let them believe that, because they suffered hardships during World War II, this was due to wartime planning. They suffered hardships because we were burning up half of our national product. They suffered shortages because we were fighting the war.

If in a modified degree this kind of unified, rational, thought-out effort could be applied to the current situation, when only 10 percent of our national product is being used for national defense, we could register gains in production, gains in real national strength, gains in national morale, gains in the true unity of purposes which mean so much to a democracy, and gains in opportunity for leadership, that would be absolutely incomparable. This is the real challenge to America in the second half of the twentieth century.

We are registering a technological breakthrough, and an automation breakthrough. We are the first country in human history that can realize the prophet's dream of disposing of "the economic problem" within this century, by making the problem of scarcity, which is the basis of current economics, a nonexistent problem. We can have so much in a material sense that we will be able to turn our entire energies to the problems of world peace, to the problems of human relationships, and the problems of spiritual values.

This is what America means to the world, and this is how America can seize the baton and leave the totalitarians so far behind that the ambivalent peoples will move to our way of life and our way of thinking, and the totalitarians will be hard pressed. But we can't do this just by talking about it. We've got to do it by doing it.

Thank you for your attention.

CAPTAIN HARROLD: Mr. Keyserling is ready for your questions, gentlemen:

QUESTION: Mr. Keyserling, a larger segment of our younger people are coming to work in the next decade. We might be able to sweep this problem under the rug temporarily, but I think it would be just temporarily. If we have a large unused industrial capacity and these people need employment, and if it can be supposed that they will increase the demand for consumer goods, durables, and so forth,

what effect will they have in bringing the economy back into equilibrium? Would not this surge of working population have a tendency to bring the situation back to a better equilibrium?

MR. KEYSERLING: No, because if mere growth in population could come close to solving the problem, we would never have had the great depression, and we would have gotten out of it very easily. It isn't more consumers that solve the problem; it's more consumption; and more consumption is based on the whole complex of national income structure. In other words, if the fact were that a family of six were by definition a bigger consumer and a bigger demander than a family of four, we wouldn't have the economic problem in the United States that we have. The problem is, if a family of six has an income of $4,000 a year, it really can't consume any more than a family of four with $4,000 a year. This is both an economic and a social problem.

I want to say another thing in this connection. We are now hearing a great deal of talk about retraining programs. In fact, this is one of the current programs. I am all for retraining. An economy always needs retraining of workers. But this isn't the central problem at all. It reminds me of how during the great depression, when I, unlike most of you, was old enough to feel it very keenly, we were told, "After all, there isn't anybody who can't get a job if he really wants to work and if he is really trained and is willing to take a job." Ninety-five percent of the people who haven't got jobs now are not unemployed because they aren't properly trained. They are unemployed because of a job shortage.

We learned during World War II that people have amazing facility. They couldn't become Mischa Elmans and couldn't become Einsteins, but they could become steel workers quickly, and even when they were drawn into the Armed Forces they could run airplanes, which is a pretty complicated proposition. It doesn't take long to train people if there is something to train them for. These people who are overstressing retraining programs ought to have a sign on their walls: "Five million Americans are not without jobs mainly because they are untrained. They are becoming untrained because they are without jobs. And even the relatively few who are really untrained need jobs to be trained for."

Another point: we have a certain number of unemployed people, and make analyses of who they are. We find that unemployment is higher among the Negroes, and unemployment is higher among the young people,

and unemployment is higher among the old people, and unemployment is higher among people with less education. This is true. But then we jump to the conclusion that the reason they are unemployed is because they are Negroes, because they are young, because they are old, and because they are uneducated. That's not so, in the main. The reason they are unemployed is because there are not enough jobs, and naturally the incidence falls upon these particular people. If all the Negroes changed the color of their skin, we'd still have the same amount of unemployment. Of course, as there is now some discrimination, changing the color of their skins would change the distribution of unemployment. But it would not change the amount of unemployment. Only more jobs can change that.

The same thing is true with respect to the young people coming into the labor force. If a young man comes into the labor force in Detroit, he can't very effectively compete for scarce jobs with his father, who may be only 42 years old, and who has seniority and skills. As a matter of fact, when he sees his father having a hard time holding on to his job, and that his older brother has lost his job, he stops looking for a job, and then he is not counted in the labor force. So you have no increase in the labor force over the year, and you think you've solved the problem. You haven't had an increase in counted unemployment, but only because the labor force has stopped growing. But this is concealed or repressed unemployment, and ultimately murder will out.

What I want to emphasize is that this is basically an economic problem. It's not basically an education problem, although education is good. It's not basically a retraining problem, although retraining is good in its place. And it's not basically a problem that population growth will solve, in the thought that more noses will in itself activate the economy. More noses merely complicate the problem if we are not handling the economic problem properly. In a nation of 180 million people a mismanaged economic problem is more serious than a mismanaged economic problem in a nation of 60 million people, because it's bigger and there are more people creating the problem. But you don't solve the economic problem simply by population growth. If you did, India would be in great shape.

QUESTION: On that same line, Mr. Keyserling, would you care to comment on this idea that if we cut down the workweek in half we would thereby solve the unemployment problem?

MR. KEYSERLING: One of the greatest tragedies confronting the American people is that, when we have great needs at home, great needs all around the world, and great needs, not only to demonstrate to our own people but to demonstrate to 3 billion people all around the world what the American society can do, we haven't got the brains and the determination to use our productive powers fully.

I am in favor of a small, gradual, annual decrease in the workweek, when a free people voluntarily decide that they want to take their increasing productive powers out partly in more goods and partly in more leisure. Leisure is good. It's all to the good that the workweek is 40 hours rather than 60 hours, as it once was, although it might be added parenthetically that because it was good to reduce from 60 to 40 it might not be good to reduce from 40 to 20, even in the long run, because the 60-hour workweek was inhuman for men in the factories.

But I am not happy about the idea of reducing the hours of work for the purpose of creating more employment by sharing unemployment. It's an economically unsatisfactory method; it's a socially unsatisfactory method; and it doesn't solve the problem satisfactorily. At the same time, in all fairness, I must say that if I were an honorable and upright labor leader, and head of a union, that had had a constant level of unemployment of hundreds of thousands, and if I knew that I had no way of modifying the national economic environment and saw those who have a way of modifying it in default, I would think I was doing the unavoidable--and in doing the unavoidable doing the right thing, because you are not doing wrong when you are doing what's unavoidable--in trying to get for those human beings under my responsibility some sharing of the evil which is not their fault. Therefore, I will not indict anybody who has this particular responsibility for trying to get unemployment shared if he can't get it cured.

But I do not like this as an economic proposition. I do not think it is an ultimate solution. And I think we have the national problem of creating jobs instead of sharing unemployment.

QUESTION: Mr. Keyserling, what specific Federal program and policy would you recommend in order to bring about this full utilization of our resources and to establish this proper balance between investment and final product demand?

MR. KEYSERLING: This would be a difficult question if economists didn't know what to do, but they do. If such a program involved any choice between what we call economic vigor and what we call personal or economic freedom, it would be a very difficult choice. But it doesn't involve that choice. What did we do during World War II? Essentially, during World War II, we established a set of national economic goals. In other words, we appraised what our productive powers were. Second, we had a set of priorities. We said, "Here are certain things we need to do as a nation first." Third, with respect to the rest of the economy, we said, "There are certain balances that we need to maintain. We've got to figure out as best we can, subject to error, what ratios of overall consumption to overall investment will maintain the economy in equilibrium and growth." Of course, those ratios were different in wartime than what they would be now.

Then we said, "What is policy?" Policy is a way of helping to allocate your economic resources. So, when you enact a tax policy, when you enact a money policy, when you enact a housing policy, and when you enact a social security policy, you use those policies to promote the fundamental relationships and the fundamental goals which you have quantified and determined and which are the essence of your economic wealth, the policies merely being a way of achieving them.

What did that procedure cost us during the war? Well, a lot of people think it cost us what it didn't. That's one of the great difficulties. During the war, we had people drafted into the Armed Forces, and we had a lot of them losing their lives, and that was bad. But this wasn't because of the economic program; this was because we were at war. During the war, we had burdensome restrictions on gasoline and on automobiles and other things; but this wasn't because of the economic program, it was because we were at war, and because a nation consuming half of its national product for explosives couldn't afford at the same time to have unlimited cars and gasoline. Yet the American people have come to think that the wartime economic program was the reason that they didn't have cars and gasoline. If it were not for that program, they would have had still fewer cars and still less gasoline on a helter-skelter, inequitable basis.

Furthermore, we did not lose during the war any of our basic freedom. I'm not talking about drafting people into the Armed Forces. That's in a different context. Business didn't lose its basic freedom.

There was no compulsory manpower act. The only incentive we used to get people to change their jobs was higher pay. We forced nobody to produce anything, with inconsequential exceptions. We did not interfere with profit as an incentive. We merely superimposed on a vast, complicated economy the degree of national purposefulness which the times called for.

If we started to do that now, I don't mean that we would have to do all the things we had to do during wartime. Let's get this perfectly clear. I don't think we'd need direct price controls. I don't think we'd need direct wage controls. I don't think we'd need allocation of most materials. I don't think we'd need to budget everything down to fingernails, the way we did during wartime. I don't even think we'd have to set goals for steel production or for copper production. But we do have to introduce into an economy, which is relatively laissez faire compared to the problems that we now confront, the problems of a $50 or $60 billion defense budget, the problems of the worldwide competition, the problems of the higher level of expectancy of people--we do have to introduce more order and discipline, and not say we are not going to do this because we did it during wartime. This, to my mind, is like saying that if we discovered a new method of surgery during wartime, we won't use it in peacetime, or a new method of anesthesia, or a new economic policy.

Now, what would we have to do? We wouldn't have to have direct controls. We wouldn't have to have allocations. But we would have to set certain broad national goals. We'd have to say, "Here is what our economy can produce. Here is what our growth rate can be."

So you set your goals and you set your growth rate, you calculate the size of your labor force, and you project, as the Employment Act intends, certain broad relationships in your investment and in your consumption patterns. Then you say, "We are not going to tell the steel industry what to do. We are not going to tell any worker what to do. We are not going to regulate prices or wages." But we do have certain great instruments of national policy, the use of which is not in dispute. Nobody is arguing now that the Federal Government shouldn't tax. Nobody is now arguing that the Federal Reserve Board shouldn't regulate the money supply. Nobody is arguing that the Congress shouldn't legislate on social security and on many other things.

If we use these goals and these quantifications as a guide to the wide range of these established national economic policies, which have universal acceptance as to their use we can begin to evolve these policies in the light, instead of flying blind. I know what I am talking about. I can read the Report of the Council of Economic Advisers--I am testifying

on that this afternoon. I can go and talk to the people in the Treasury. I can go and talk to the people in Housing. I can go and talk to the people in the Health and Welfare agency. They are establishing certain programs and certain objectives, but too much in terms of inertia, too much in terms of tradition, but not enough in terms of any rationalized picture of what our national needs are or how these things fit together, or what kind of tax policy fits in with the kind of resource pattern that we want to get.

This I say we have to do, not only in wartime but all the time, because it is a simple principle of sensible management and intelligence. We can't afford to fly blind. This wouldn't interfere in any sense with our system as we understand it. It wouldn't interfere with the capacity of leadership to explain it to the people. It would make it easier to explain it to the people and it would make it easier to explain it to the Congress. We are not doing this well enough. I don't know what we are afraid of.

QUESTION: Mr. Keyserling, you mentioned during your discussion that the measures we had taken with respect to balance of payments you considered arrant nonsense. Nevertheless, it seems to me that in attaining a higher consumption level the balance of payments problem is a constraint. Would you care to discuss that?

MR. KEYSERLING: Yes. During the Eisenhower period, the threat of inflation, which is a genuine problem, was so misused that the Government was able to depart from a full employment policy, a full production policy, and a socially just policy, all on the ground that that was the way to restrain inflation. In other words, it was said, full employment is "inflationary;" a higher rate of economic growth is "inflationary;" the defense or the education that we need is "inflationary." Under a misuse of the legitimate fear of inflation, most of which, incidentally, had been engendered by war, the American people were led away from the things which they needed to do, and which, incidentally, would have been a much better way of containing the kind of inflation that we had after World War II, which was not an inflation resulting from growing too fast but was an inflation resulting from the inefficiencies of growing too slowly. In other words, it was an inflation which resulted from the efforts of specific groups to get enough profits despite the fact that so much plant and manpower were idle. It was an effort to compensate for the low rate of economic growth and the high level of unemployment by higher returns per unit. It was a perfectly straight low-growth inflation, and this the economists are just beginning to see.

Now we've come to a new period, and basically the same forces which had misused the problem of inflation are now using a misanalysis of the balance of payments problem in order to say that because of the balance of payments problem there are many restraints imposed on what were earlier set as objectives under the New Frontier. So it is said that we should jack up the interest rates to stop the flow of capital from the United States. It is said that we should restrain wage increases to encourage foreign purchases of our products.

I don't want to go into the whole wage question, but we haven't exactly had explained to us how, if we had $10 billion less of wage payments in the United States, this would help sell anything overseas without also meaning $10 billion less of purchases by American wage-earners in the United States. This the economist does not exactly explain to me. Some day maybe he will. There are lots of other problems besides that.

Why do I say that the external evidence is clear that, on the basis of concern about the balance of payments,we have departed from sound approaches to a higher rate of economic growth? What's wrong with the current balance of payments approach? This takes a little while, but it's complicated, and it's important.

The so-called balance of payments problem involves two things. It involves the balance of payments problem and the gold problem. They are two entirely separate problems, and they've gotten to be entirely mixed up.

Let's take the balance of payments problem first. The balance of payments problem is said to exist because, during the past few years, we have been running an unfavorable balance of payments. We have been running this because, although last year we exported, let's say, $6 billion more of goods and services than we imported, this was not enough to cover our private investment overseas, our grants overseas, and our military establishment overseas. It is basically recognized that, while we may and should get some rediversion of our private investment overseas from the developed to the underdeveloped countries, we can't cut our private investment overseas much. And we can't cut our help to the underdeveloped countries. Therefore, we are going to get rid of our unfavorable balance of payments problem, so it is said, by increasing our export surplus on our goods and services account from $6 billion a year to $8, $10, $12 billion or what have you. Then it is said that, in order to do this, we have to hold wages down in order

to hold costs down. It is said that, in order to do this, we have to have a budgetary surplus to encourage savings, which will in turn encourage more investment and higher productivity. And so forth and so on--the whole panoply of what I call the conservative, for lack of a better term--let's say the whole panoply of an outmoded basic economic policy is subsumed under this balance of payments analysis.

What's wrong with it? The first thing that's wrong with it is that, on the goods and services account, there's nothing wrong with what our position has been. We had a $6 billion surplus last year. This is far above the surplus that we can maintain, because it is a surplus which is derivative of a postwar period in which a lot of other people were bombed out and a lot of them weren't developed at all. You can't conceive of any viable free world of the future if England is going to develop, if Japan is going to develop, if Western Europe is going to develop, and if the underdeveloped countries are going to develop, where we can have a larger export surplus. We can have a larger world trade as part of the free world economy, but we can't capture any larger share of the markets in the free world, except at the expense of countries like Japan, and Japan will soon have 100 million people. How are they going to live? They are much more dependent upon an export surplus than we are. We'll throw them directly into the Communist Chinese orbit if we do that. This applies to a degree to England in a different way, and even to the countries of Western Europe.

The problem hasn't been analyzed and thought through. There's nothing really wrong with our competitive position overseas. Even if there were, and even if we wanted a higher level of investment and a higher level of technology, which I think we do, the whole thing I pointed out earlier in my talk was that in order to get this we have to have a higher growth rate, and then we'll have more investment and we'll have a more rapid advance in technology, for whatever that might be worth with respect to the balance of payments. But, by employing, for solving the balance of payments of problem, a fundamentally wrong basic national economic policy, we are maintaining the low growth rate, we are maintaining the inefficiency of high unemployment, we are maintaining a level of investment which is too low in the long run, for the reasons I have given, and therefore we are defeating ourselves, just as the Eisenhower policy was self-defeated in dealing with the problem of inflation.

So I think we've got to run, actually, an unfavorable balance of payments for a few more years until the free world gets into a more viable position. Then you get the question: How can we afford it? The answer is we can afford to run an unfavorable balance of payments for a few years in a $500 billion American economy in the same way that we could afford not to listen to the people who almost 30 years ago were saying that if Roosevelt lifted the Federal Budget about $6 billion a year, or if the national debt was more than $30 billion, we'd go to hell in a hand basket. We know that's just not so.

What we have to do is to set up an international mechanism for clearing and relating long-range and short-range claims, because we are not in an unfavorable balance of payments position on a long-range basis. Second, we have to expedite the rate of growth of the United States, which would reduce the withdrawal of foreign capital from the United States and would reduce the flow of U.S. capital from the United States to the developed countries overseas now occurring because of the marginal advantage which the Western European countries have over us when they are growing twice as fast as we are. That will be a fundamental remedy.

Then, we have to disassociate from excessive dependence on gold, by removing the 20-percent gold reserve--which is absolute nonsense, and no other country in the world has it--ultimately getting away from the anachronism of gold as a basis for the currency at all, because it hasn't much real value any more, not even to fill teeth with. Further, the production of gold throughout the world is growing only at 1.5 percent a year. If we tie our monetary system and economic system which need to grow 5 percent a year to a world supply of gold that can grow only 1.5 percent a year, we are by definition tying the dog's tail to a tin can, and then tying the tin can to an anchor. The whole thing doesn't make any sense.

This isn't peculiar to me. One aspect of this was recommended by the head of the Morgan Guarantee Trust Company. As a matter of fact, a proposal on this was advanced by the President of the United States, but it was withdrawn because some people opposed it. Well, it's going to have to be proposed again.

CAPTAIN HARROLD: Mr. Keyserling, I think we have run out of time. On behalf of the Commandant, our guests, and the student body, please accept my thanks for a most stimulating morning. Thank you, sir.

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