THE AMERICAN ECONOMY IN THE FUTURE

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Mr. Leon H. Keyserling, Consulting Economist, was born in Charleston, South Carolina, 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 1938-1942 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 Congress of 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." This is his seventh lecture at the College.

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COLONEL COLMER: General Mundy, Gentlemen:

I have a natural propensity to say the wrong thing. Our speaker this morning is a native of Beaufort, South Carolina, some miles, I think, from Parris Island, and the hometown of my wife. Most of the successful natives leave Beaufort early in life and go north and get married up there. That leaves a residue of women in Beaufort, so that the Commandant of the Marine Corps has to comply with the wishes of the fathers of the girls in Beaufort, and sends a batch of bachelor lieutenants down to marry the girls. Our speaker is no exception, and I was one of the bachelors.

Fortunately, our Economic Stabilization Unit comes at the beginning of a new Federal Administration, in particular a changing Administration. As the echoes of platform promises, campaign diatribes, and the virgin economic analyses of both parties are overshadowed by the decision of the electors, we can now observe and study the course of events toward the promised new frontiers.

Although the Administration is but 13 days old, we can begin to detect the program of policy it intends to advance, and after tomorrow we will have a better insight.

Our speaker, Mr. Leon Keyserling, has figured prominently in shaping the economic thinking of the Democratic Party since the early thirties. He is eminently qualified in broadening our perspective on the subject of his talk today, "The American Economy in the Future." He has written many articles and periodicals and has frequently met the press. He was Chairman of President Truman's Council of Economic Advisers. He is a consulting economist and an attorney, and presently he is President of the Conference of Economic Progress. A publication of this group is part of your required reading this morning.

Mr. Keyserling, it is a pleasure to welcome you back to the Industrial College of the Armed Forces and to introduce you to the Class of 1961.

Mr. Keyserling.

MR. KEYSERLING: I really want to express my appreciation of having been here so many times and being asked to be here again. I welcome especially this opportunity to see this magnificent new structure and auditorium. I often wonder why I have been asked here a number of times. It doesn't afford me very much happiness, because I think that the real reason is that time has tended to vindicate the unpleasant forecasts which I have made. I would be much happier if I had proved to be a false prophet. I have felt for many years, regardless of the "political" affairs in which I have been involved, that the American people, the American Government, and the American leadership, while they have done better than in the distant past, have not done nearly so well as we need to do in view of the challenge of the present and future.

This deficiency has made itself particularly manifest in our economic affairs. One of the reasons for this is that economic affairs, more than almost any other affairs, are subject not only to differences of opinion but also differences of group interests. This is one of the prices which a free society has to pay, and I don't believe it is too high because I believe in a free society. Nonetheless, these group interests are not always the same as the public interest, even though the public interest in a democracy is a composite of group interests.

Another reason why I have been invited here again and again, I suppose, is that at least during the past eight years I have been able to salt my talks with the entertainment of criticizing an Administration of which I was not a part. I hope, however, that I gave evidence in these talks of willingness, as the record shows, to point out that during the Truman Administration also, in which I served not only in peacetime but also in wartime, we neglected to do many things which our economy was capable of doing, and which seemed to me essential during the times in which we then lived.

While the new Administration has been in office for too short a time for me to form any exact appraisal of what it may do, I said in the other room that I don't know how long it will be before President Kennedy joins the most select society in the world, the society of American Presidents criticized by Leon Keyserling. I don't think that's worrying him too much.

Some General Comments On Economic Growth

There's still a lot of confusion on the subject of economic growth, particularly at a time when we are again suffering from high-level unemployment, and when everybody is talking about getting out of the economic recession. In fact, I recently read a task-force economic report prepared under the Chairmanship of Mr. Sproul, the former Chairman of the Federal Reserve Board of New York, in which he said that the problem of economic growth is not an immediate problem, because we have the problem of gold, the problem of balance of payments, the problem of the recession, and the problem of reducing the level of unemployment.

Putting aside the problem of gold and the problem of balance of payments for such questions as you may want to ask me in the subsequent question period, there is no real distinction between the problem of getting out this recession and the problem of economic growth, and no real distinction between the problem of economic growth and the problem of unemployment. Those who exaggerate these distinctions and translate them into public and private policies are doing the country a great disservice, arising mostly out of misunderstanding. I never question their good motivation.

The only attitude toward economic growth which has large meaning is not whether we are growing faster or slower than the Russians, faster or slower than the Chinese, or faster or slower than the Germans, although these comparisons have important side implications. The only attitude toward economic growth which has large meaning is: Are we growing fast enough to use our own potentials? Are we growing fast enough to utilize the growing size of our own labor force, including brains as well as brawn, and to utilize the growing productivity of the American technology?

A growth rate in the economy is too high except under the necessarily forced pressures of wartime when it places excessive strain upon our productive resources, overuses them, depletes them, and subjects them to the kind of inflation which results from overuse. The growth rate is too low when it allows more and more of our expanding productive resources to become unemployed. Unemployed plant and manpower are byproducts of too low a rate of economic growth. Or you can turn it around and say that too low a rate of economic growth is the consequence of an inadequate employment of plant and manpower.

The second important thing to realize is that there is no prime distinction between the problem (in which we now find ourselves) of getting out of a recession and the problem of establishing a long-term record of adequate economic growth. The distinction exists only in the minds of those who say that we should first get out of the recession and then talk about a long-term program of economic growth. These people are still wedded to the random, improvised, ad hoc, day-by-day treatment of our economic problems which has put us at such disadvantage because it reflects the lack of any long-range analysis of where we really are and why.

To illustrate this, and for other reasons germane to my talk, I want to give you just a few figures on what has happened to us in recent years on the subject of economic growth and unemployed plant and manpower, and then tie it in with the current situation and what we need to do.

I sometimes think that the difference between most businessmen and most economists is that most businessmen look at the facts without asking what they mean, and most economists tell us what everything means without looking at the facts. What we really need is somebody who tries to look at the facts and tell us what they mean.

Recession, Booms, and Stagnation

I begin my analysis with the end of the Korean war, I don't select this starting point, for political reasons. I select it because, since the end of the Korean war, we have been in the kind of period we are likely to remain in as far ahead as we can see, a period between war and peace, a cold war period, a period where the economy is neither galvanized automatically by the flames of war--large or small--nor truly at peace.

During the eight years, we've had three distinct kinds of economic development, which I shall define simply. I define a "recession" as a period where the total activity of the economy, as measured by the gross national product in real terms, is moving downward in absolute terms. If your gross national product is moving downward, you are in a "recession." That's a good enough definition for our purposes here. Naturally, this means rising idleness of manpower and plant.

I define a period of adequate economic growth as a period when the total national production is moving forward rapidly enough to absorb the growing increments of technology and plant and manpower, and, if you happen to be in a period of great economic slack, the growth rate must be even faster to take up the slack within a reasonable time.

I define a period of "stagnation" as a period when the economy is growing in absolute terms, but growing so slowly that it is really falling behind its production and employment potentials at the same time that it is growing. This is a very simple concept, but one that seems never to be able to get into the heads of people who want to claim that we are "higher than ever before," without asking whether we are enough higher as to be maintaining a condition of economic health. In such a period, idle resources are rising even while the economy is moving upward in absolute terms.

If we bear clearly in mind these three types of periods--the period of absolute recession, the period of adequate economic growth, and the period of stagnation--we realize that we have never had, during the past eight years, a period of adequate economic growth. What we have had, very simply, is this: From 1953 to 1954 we had an absolute economic recession. From 1954 to 1955 we had a boom growth rate of about 9 percent, which looked very high, but it wasn't high enough nor sustained enough to restore reasonably full use of our productive resources. In short, the so-called boom from late 1954 forward was terminated, was aborted, before we got back to full use of plant and manpower. Then it was succeeded by two years of economic stagnation, from 1955 to 1956 and from 1956 to 1957, when the growth rate fell to about 2.5 percent, and then to about 2 percent. So we had those two years of stagnation superimposed upon an inadequate recovery.

The record of my talks here will show that, being in 1955, and again in 1956, when so many people were shouting that we were on our way again and that the only danger was "inflation," I was pointing out that we has solved none of the basic problems of maladjustment, that the recovery period would be short and insufficient, and that it would be succeeded by another period of stagnation and then another recession. And so it came to pass.

In 1957-58, after two years of stagnation, we got into another absolute recession, a little bigger than the previous one. Then in 1958 we started another upward boom movement, and again people said, "We are on our way. The only problem is inflation. Let's repress the economy." But this recovery was not as large nor as long as the previous recovery. It didn't carry us back even as far as the earlier one toward reasonably full use of our productive resources. Then we got into another period of stagnation, about which I talked to you last year, and then we moved into another absolute economic recession early in 1960, from which we are not out yet.

So the American economy has registered, during these dangerous eight years, a process which I call a roller coaster kind of performance, down a bit, up a bit but not enough, sideways a bit, then down again.

When we say that the overall rate of economic growth during these eight years has averaged annually only 2.5 percent, rather than the about 4.2 percent which was needed during this period to keep our resources reasonably fully employed, we mean that the sum total of these ups and downs has averaged about 2.5 percent. We don't mean that a free and flexible and dynamic American economy should grow in an absolutely straight line. The people who say that Keyserling says we should have grown in a straight line of 4.2 percent a year don't listen to what I am saying. I'm saying that the jagged line representing the line through which a straight line would run if it were drawn on a sheet of paper should have averaged about 4.2 percent over the years rather than 2.5 percent.

Low Growth and Wasted Resources

The vindication of this thesis is that, due to averaging this low 2.5 percent rate of growth, we have had a gradually increasing disemployment of plant and manpower. I don't mean that this has increased every year. Obviously, at the peak of one of these short periods of recovery, we have less employment of plant and manpower than at the trough of the immediately preceding recession. Nonetheless, at the peak of each of these short recoveries, we have had more unemployment of plant and manpower as a percent of our productive capacity than at the peak of the previous recovery; and at the trough of each recession we have more unemployment of plant and manpower than at the trough of the previous recession. Furthermore, at the peak of each recovery we have more unemployment of plant and manpower than we had two or three recessions back. So we are moving gradually toward the wasting of our economic strength through a gradual and chronic rising unemployment of plant and manpower.

Because this is so important, let me give you just a few figures on this particular point, and then try to go into the question of why this happened, and what it has cost us, and what we need to do about it.

To show how we have had this increasing level of unemployment of manpower, I'll skip the recession years, and deal only with the prosperity years, to show how each prosperity period has left us with more unemployment than the previous prosperity period, and then I'll relate this to the size of the labor force, because otherwise you may say, "Well, we have more unemployment, but there are more people in the labor force."

I take two kinds of unemployment, but the point would be illustrated by either. First, I take full-time unemployment, which is unemployment reported by the Census Bureau. And second, I take another figure, also derived of course from Government statistics, which is the full-time equivalent of part-time unemployment, unfortunately not reported by the Census Bureau, but nontheless representing wasted resources. If a plant goes on half time and employs people 20 hours a week instead of 40, there is no full-time unemployment. It is not counted as unemployment by the Census, but it's the same as if the plant had disemployed half of its people for the full 40 hours--the same thing from the economic point of view, from the production point of view, and from the point of view of how the economy is functioning. It's just a little more humane.

Counting both full-time unemployment and the full-time equivalent of part-time unemployment, the true level of unemployment in 1953 was 2.8 million, despite the fact that a recession started in the middle of that year. In 1956, which was a boom year, the true level of unemployment was 3.9 million. In 1959, which was also a boom year, the true level of unemployment was 5 million. In 1960, which was partly a recessionary year, the true level of unemployment has risen to 5.3 million. By December, 1960, it had risen to 6.4 million, (seasonally adjusted).

Now, let's look at unemployment as a percent of the civilian labor force, which in some ways is more revealing. As a percent of the civilian labor force, the true level of unemployment was 4.3 percent in 1953, a year in which a recession occurred; 5.8 percent in the boom year, 1956; 7.3 percent in the boom year, 1959; close to 9 percent in December 1960, seasonally adjusted; and about the same in January 1961. So where are we?

We are now in a situation where our unused manpower, as a percent of our labor force, is about 9 percent. I believe that, in view of our domestic needs and the world situation, we cannot afford to spot either Western Europe (in terms of certain problems of competition with Western Europe--problems which have been exaggerated but nonetheless exist) or the driving, organized Eastern totalitarian powers, with a 9 percent unemployment rate in the American labor force.

Why have I emphasized this? Some of you say, "Well it's 9 percent, but we are in a recession. The seers tell us that we're going to be out of the recession by the middle of 1961." The point I am making is that we heard similar complacency during the recession of 1953-54, and the recession of 1957-58. But if we continue during the next few years the path we have been following during the past eight years--and I think we are in danger of continuing that way, for reasons which I am going to state--what would happen? At the peak of each prosperity boom, unemployment would be much higher than during the previous boom, and two or three booms from now we will have more unemployment than we have in this recession. And in the next recession, unemployment would be very much higher than in this one. If we repeat the average annual growth rate of 2.5 percent, unemployment by 1965 could be 50 percent higher than now.

Unemployed plant and technology are equally serious, I can't give you exact figures, because we can't put all the plants in the United States together and get an index of them. But, broadly speaking, we may take it as an axiom that unemployment of plant and technology is now greater than unemployment of manpower. In other words, if the unemployed manpower is now 9 percent of the civilian labor force, unemployment of plant and technology is about 15 to 20 percent of the effective plant and technology in being. This also is rising in the long run, with each prosperity boom finding us with more unemployed plant and technology than the previous boom, and with each boom finding us with more unemployed plant and technology than two or three recessions back. So we are moving toward a gradually increased level of unemployment of plant and technology.

What has this cost us in other terms? The simplest way of summarizing it is to say that, during the past eight years which I have been reviewing, this unemployed plant and manpower may be highlighted as follows: Measured in uniform 1959 dollars, we've forfeited about $260 billion of national production, and we've lost about 18.5 million man-years of employment opportunity. We can break that down further, into the things we need to do as a nation.

The Problem of Imbalances in the Economy

There are some people who say we've had too many automobiles and not enough defense, and that the thing to do is to cut back on tail fins and have more defense. This would be very sensible, if the American people were fully using their resources and had to redistribute this use. But when we have had this tremendous slack in resources, we need to produce and distribute more of almost everything, in balanced proportions. To achieve these balanced proportions, and thus to keep the engine running fairly smoothly, the task of economists is to ask: What are the imbalances in the economy? What are the defects which produce this cronic disease of rising unemployment of plant and manpower?

Without attempting to be captious, it is terribly disturbing to me that the bulk of our American economic thinking is short on quantitative analysis, still so lacking in the determination to look at the whole picture. To be sure, many economists have views that they like to put forward, based upon textbook or classical propositions as to how to respond to various economic situations. But there is a serious dearth of careful and comprehensive adjustment of proposed measures to quantitative analysis.

What I am really saying is that we've got to put our thinking about economic matters on a quantitative and overall empirical basis, in the same way that we did in a full-scale war. I don't mean that we now need the same degree of controls, or the same degree of centralized authority, that becomes necessary in time of war. But I do say that, if we are going to have effective economic action in these times, we must develop a full picture of what resources we have available, how we want to blend them, where we want to go, and how tools can be attuned to basic objectives. We must also keep a constant tab on results as we go along, in order to make needed adjustments promptly and correctly.

We don't have this kind of economic effort in the United States, except in wartime. We have various proposals to change the tax laws, to change the money policy, to provide a little unemployment insurance, to provide a little addition to social security, to add a little to national defense. But we do not have any rounded, composite, thought-through comprehensive program for dealing with our economic problems.

Our vital need for this more thorough approach is not totalitarianism. It does not foreclose a proper balance between what Government does and private enterprise does. It does not impair political freedom. This vital need is simply that, whatever the composite may be at any given time, the policies which are executed by the Government and the policies of private enterprise which have national significance and impinge and interact upon what the Government does must have some interrelated rationale and must not be flying blind. This is particularly true of public policy.

To prove my point, that we haven't been thinking these issues through, let me give one illustration of what we sometimes hear in connection with current discussions of policy. We hear, "Well, Keyserling is right that we've had far too low a rate of economic growth. He's also right that there has been far too much unemployed plant and manpower. He's also right that this has starved our essential public services and our national defense, because these programs are paid for economically out of production and paid for financially out of taxes. If there is a production deficit of $260 billion over eight years, we lose about $90 billion in public revenues at existing levels of taxation, and thus are not able 'to afford' the national defense we need, the education we need, the highways we need." It is generally admitted that I am also right in saying that, with a higher rate of economic growth, we could have large improvement in private living standards, which is essential in a democracy, and is also essential because we have a great deal of private poverty and low incomes in the United States.

But then, many of these people who agree with me up to this point, say, "If we are we must have higher productivity and more technology. Therefore, we must adopt specific economic policies which provide particular kinds of incentives to business investment."

Bear with me. I'm not against business investment. I am not against profits. Let me illustrate what I mean. Suppose that, despite the 2.5 percent rate of economic growth during the past eight years, we had enjoyed reasonably full utilization of our resources. This would have meant that the growth in the labor force, plus the growth in productivity and technology, was averaging annually only 2.5 percent. In that event, we would have needed to speed up investment in technology and productivity.

This, indeed, is the problem of the underdeveloped nations. This is also our problem in wartime, when our resources are strained, and when we need tax amortization plans and other measures to expand our productive capabilities at a hectic rate.

But the low rates of economic growth in recent years has not been due to low growth in technology and productivity. We have had the low rate of economic growth with a rising level of unemployed plant and manpower, which means that the actual growth in productivity and technology and labor force has not been used. Therefore, there is very little use in trying to stimulate more plant building and more technology already in being.

As I have said here many times before--and it is increasingly illustrated by recent developments--the economists, the businessmen, the analysts, have underestimated the growth taking place in American technology and productivity in the factory, on the farm, and in the office building and everywhere else. It is growing at a fantastic rate. The problem is to get a high enough level of demand, a high enough level of consumption, to utilize this technology. If we meet this central problem, both the funds and the incentives will be available for the increased expansion of investment, in balanced proportions with the growth in demand. Then we will have an equilibrium throughout the economy, and the investment in technology, which is important, and the expansion of plans, which is important, and the expansion of consumption, which is important, will all proceed in balanced proportions.

The Need for a Comprehensive View

Suppose somebody says, "Well, this is your analysis, but others feel differently." That's not the point. Of course I happen to think my analysis is substantially correct. It's based on careful observations of the economy, and on careful quantifications. But this isn't what worries me. I wouldn't worry too much if the economists and the policymakers got a different result. I'm more worried about their methods. They are not making a full empirical observation of what has happened, and what went wrong, and where the distortions have been. Therefore, the tax policies and the money policies and the other policies which are emerging are not emerging from sufficient analysis. They are emerging from the inertia of what was done in the past. They're emerging from the competing pressures of various interest groups, one group saying, "We want some tax reduction;" another group saying, "We want another kind of tax reduction." And so forth, all up and down the line.

So, what do we need? We need somewhere, at some reasonably central point heading up to the President, a type of planning--I'm not afraid of the word because I think a free society has to plan in this kind of period to keep up with the totalitarians and to fulfill our own purposes--a type of planning which makes a tableau of the whole economy in operation. On the basis of this tableau, we need to set consistent goals, and large consistent programs for their attainment. These programs, like pearls, can't be handled in escalation. They need to be matched and fitted together on a string. This is the meaning of a mature, intelligent economic policy in these times, so that we don't take one step forward and two steps backward, and so that one policy doesn't cancel out the other--and above all, that we don't do too little too late.

The Size of the Job Ahead

Let's talk about the too little too late, which is the most important thing of all. Here we are in a situation very similar to the last economic recession, except bigger. We get a fairly good impression of the size of the job ahead if we read the first economic task force--the so-called Samuelson--report. What does it say? It says that, if we had grown at a reasonable growth rate just since 1956--not since the end of the Korean war--we would have had a national production for 1961 as a whole about 10 percent higher than what it is now likely to be. Applying this to a $500 billion economy--I am speaking roughly--we get $50 billion. I think the figure is close to $75 billion. Adding to this the continuing growth in the labor force and productivity, the size of the job is this: To restore reasonably full employment even by the end of 1962, we need a total national production about $45 billion higher in 1961 as a whole, and about $85 billion higher in 1962 as a whole, than the annual rate in fourth quarter 1961 (seasonally adjusted).

Measured against the immense size of this task, the programs now under active consideration are extremely small--for example, a fiscal 1962 budget only a few billion higher than the 1961 budget, and no really basic changes in monetary or tax policies. We haven't awakened to the size of the task of reasonably utilizing this tremendous, fantastic productive power of the American economy, which is becoming increasingly a Frankenstein, created by our own hands, unless we learn how to use it more fully.

What we are misapparising is not our liabilities but our assets. What we are misappraising is not our dangers but our opportunities. In consequence, we are not bringing forth the programs to do what everybody in general would really want to do. And the reason we are not doing it is not bad intentions, not even lack of information, but rather that, except in wartime, for some strange reason, we seem utterly unwilling to make the kind of examination of our economy, the kind of quantitative appraisal, the kind of realistic judgment of programs, required for the job we need to do.

This isn't the same as a wartime job. But to say that nothing we learned about economic management during wartime is relevant today is just like saying that, if we discover during wartime a way of conducting a surgical operation more successfully, we should not use it in peacetime because it is peacetime.

We don't need the direct controls we had during wartime, in any foreseeable situation. We don't need tax rates as high. We don't need a monetary policy as strict. But we do need a tax policy that's just as intelligent, and we do need a money policy that's just as intelligent, and we do need other economic policies that are just as intelligent. And they can't be sufficiently intelligent without analysis, they can't be sufficiently intelligent without looking at the whole economy, and they can't be sufficiently intelligent without being consistently adjusted to a full "economic budget" of our total needs and potentials in balanced proportions.

The Cost in Future of Low Economic Growth

Let's examine what may well happen unless we plan more comprehensively, and bring forth more vigorous effects than these now under active discussion. If you will check back the record of what I have said here over the years, you will find that I have neither exaggerated nor been far off the beam.

There's no reason to suppose that the "automatic forces" making for growth are now stronger than they were in 1953. I think they are weaker. A lot of the forces of cumulative "backlogs" which existed because of World War II and the Korean war have by now been worked down. We haven't got things hanging around in the sky to make the performance better. And I think, since we are starting now within a recession, that my assumption is sound, we are not going to make a much better growth record during the next 5 years than we made during the past 8 years, unless we make redoubled efforts.

Where would this carry us? Very roughly speaking, I have some estimates here of where it would carry us. First of all, if during the five years 1961-1965 inclusive we grow no faster than during the eight years 1953-1960 inclusive, we would forfeit almost $400 billion of national production. We should experience about 20 million man-years of forfeited employment opportunity. Even with considerable reduction in tax rates, which I believe desirable, the high rather than the low growth rate would yield about $95 billion more in public revenues (at all levels) during the five year period 1961-1965 inclusive.

This $95 billion would provide an average of $19 billion a year, for these five years, for national defense, education, or whatever range of great national priorities we might decide as a nation to serve.

This use would not impose upon the American people burdens in their private lives which might turn them against what we need to do as a nation in times of relative peace, when it is hard to make the people thoroughly understand these tasks. If we have $400 billion more of national product, and use $95 billion of it for essential public purposes, there is still about $300 billion more for other purposes. That $300 billion would flow into the improvement of the living standards of the American people, and the sound expansion of technology and investment, because there would be a demand calling forth investments in balanced proportions.

Approaches to Policy Formation

What ought we to be doing in the future? Well I am repeating what I have said so often in the past. If we were to develop what I call "An American Economic Performance Budget" to gear our potentials to our needs, a long-range Federal budget should become an integral part of this performance budget.

Today, we hear speculation about how big the Federal budget is going to be in terms of the outlook for revenues and "political feasibility." But if one is thinking in terms of national economic performance, as we do in wartime and should do now, we would quickly recognizethe correct principles to apply to the Federal budget.

The Federal budget on the spending side represents the priorities of the nation. If the Nation has the potential to grow and advance at a certain rate at full employment, then the expenditure side of the Federal budget should represent the portion of that full employment product which outht to flow into our national priorities. Let's say it is 15 percent. On the basis of a $600 billion economy, it would be $900 billion. If it is 20 percent--these are matters of national policy--on the basis of a $600 billion economy, it would be $120 billion. That would be determined, as it is determined in wartime, by what part of our national product we want to use for national defense, for education, for schools, and for roads, and so forth, to help build the strength of the nation.

The budget is a determination of priorities. That's all it is. People say, "Sure, if you get the high rate of economic growth?" you'll have these revenues, and you'll be able to do this without deficits, but suppose you don't get the high rate of economic?" The answer to this is very simple if we think rationally. If we don't get the high rate of economic growth, then we have highly unemployed plant and manpower. And if we have this unemployed plant and manpower, then a deficit in the Federal budget is good for the national economy, and therefore good for the Federal budget in the longer run.

Similarly, it is erroneous to argue that, if the economy is growing very fast, the spending side of the budget should be reduced to fight inflation. What does this really mean? It really means that, if we grow 5 percent and have a big national product, we can't "afford" as much for national defense and education as if we had a lot of unemployment and had a lot of unused plant. This is obvious silly and upside down.

It is the tax rather than the spending side of the budget which should be varied for purposes of economic stabilization. Tax policy should be used to run a surplus in inflationary times and a deficit in times of large economic slack.

These issues are so tremendous that, if you think that I have overstated or mistated either the size of these issues or the nature of the approaches we must take, I urge you to note carefully the extent to which most of those who talk about the American economy talk merely about their views on taxes or their views on inflation or their views on money policy. Seldom do they really attempt to set these tools, these instrumentalities, these implements, within the context of what our real wealth is and what our real problems are, and how we can fully mobilize the only source of real wealth, namely, the employment of manpower, brains, skills, organizing power, financial resources, the values of free institutions, so that our economy will run like an auto which neither boils over with inflation nor suffers the flat tire of deflation or low economic growth.

We must also remember that the purpose of a car driver is not just to know how to fix the tire which gets flat, which we might compare to deflation, nor just to know how to deal with the engine which overboils, which we might compare to inflation. Listening to many economists, one might think that the only two problems are to deal with the overboiling engine and the flat tire. The purpose of an automobile is to run it efficiently in a given direction and get where we want to go, and to know where we want to go and to have an important target.

The person who cares only about the flat tire and the boiling engine is likely to stand still in the middle of the road, or to wobble slowly toward a deficient goal in terms of our potentials.

This is the essential point I am trying to make.

Thank you for your attention.

COLONEL COLMER: Mr. Keyserling is ready for your questions.

QUESTION: I would like to ask a question about overemployment. One of the factories we visited in Houston, when I asked if the people on the shift worked one shift this week and another next week, they said, "No, because almost all the women are married to the men, and they come to work together and go home together." They had several thousand women employed, and they said that most of them were married to men who worked there, and they had at least one child. At Fort Riley, Kansas, I had a sergeant working for me who was making $400 a month. He had a job at night in a filling station. His wife taught school and worked in a grocery store on Saturday. They had a 17-year-old son who quit high school to work at the PX. It looks to me like we have some unemployment and we have overemployment. It is significant? Would you comment on it?

MR. KEYSERLING: First of all, without in any way challenging the examples you have given, we can always find some examples in our vast economy of almost any situation. But I don't think your problem is of general significance, for these reasons: My figures show that the total demand upon our economy, which is the composite of public demand, plus investment demand, plus the demand exerted by private consumers earning incomes from all sources, is less than enough to avoid excessive idleness of plant. In other words, the earnings and spending of people who have two jobs or six jobs and of families with two workers or three workers, are all included in the consumer income and spending figures. Consumer spending plus public spending is not adding up to the full utilization of our plant and equipment, so that the general problem which I am talking about is not affected one way or the other by the fact that some people have two job or that some families have two jobholders. The total demand is nonetheless deficient, and total income is deficient, and therefore total man-years of employment is also deficient.

I think it is true that, so long as we have this total deficiency in man-years of employment, it might be more humane and rational to spread this unemployment in a different way, in other words, to have one worker in each family, instead of two workers in one family and no worker in another family. But this is a relatively minor aspect of the problem. More fundamentally, I am against the "solution" of sharing unemployment when we have so many needed things to do as a nation. I'm against it for the same reason that I would be against saying, "Let's, instead of having a 40-hour week, have a 30-hour week, so as to share the unemployment."

My philosophy is that, under a free system, nobody except the individual and the family should determine how many people in the family work. I think there should be laws against childern working. I think there should be laws to protect the working conditions of people. But I do not believe that, in a free society, it is desirable to try to pass laws as to whether or not a woman shall work, or how many people in a family shall work.

I think our problem as a nation is not to share unemployment, but instead to recognize that any responsible, modern, civilized society should be able to use what it can produce at full employment. I do not believe that a nation which sets out to share unemployment can compete with nations, like Russia, like China, which are finding ways to use, for their purposes which we do not agree, their growing productive resources.

This doesn't mean that we should have as many women working as Russia does. I am saying that a nation is deficient in economic policy when it says, "We have the technology, we have the people who want to work and are able to work, who have the creative urge, who want to earn income, who want to be useful, we have the needs, domestic and international, but we can't find the ways to make the engine work so all these people can have a chance to do a job. Therefore, we'll shorten the hours of work; we'll plow under the little pigs; we'll destroy crops; we'll make laws that nobody can hold two jobs, and that no secondary worker can work."

I don't think this is the solution. I think it would compound the economic problem, aside from everything else.

That is my general answer to the question. I hope it is satisfactory.

QUESTION: I hope I can phrase this, sir. Mine is a little bit along the same line. We've got a farm surplus in this country. We've got hungry people in the country and we've got friends in the so-called free world coalition to whom we can't give this farm surplus, apparently, because this would put some other friends out of business. We've been told that we'll never again see the number of steel workers employed that are employed at this time, today, but that our steel production can continue to go up if we desire it. My question is: Is there an analogy between the overproduction in the farm area and the potential production of our industry, particularly with respect to the international picture?

MR. KEYSERLING: We have to distinguish between specialized overproduction in some areas, and generalized overproduction, which I maintain cannot exist, but is rather underconsumption. It is perfectly true that any nation going through industrial development can have absolute overproduction of certain things. In other words, if we continued to produce buggies, there would be an overproduction of them under any given set of economic circumstances, So we have to shift people from making buggies to make something else.

Similarly, even if we use as much of our food at home as we should to prevent the great amount of malnutrition which there still is in the United States--and I agree with that--and use more of it overseas--and I agree with that--the trends in our farm technology are such that we must face a gradual further decline in the farm population. But total use of all products must rise with total productive power, or we are in deep trouble.

To show you how far our economic thinking gets away from this reality: a few years ago, some economists were telling me that we didn't have to worry about the fact that people had to be moved out of agriculture, because they could go into industry. I said, "Where are they going in industry?" Now we know better. Now some of these same economists are saying, "We don't have to worry about the unemployment in industry. They'll go into the service trades. They'll go into the office buildings." The same technological displacement is now happening in the office buildings.

Some economists are looking at the unemployed people and are saying, "This isn't a general economic problem, as Keyserling says. This is a problem of the structure of the labor force." They say, "If you look at most of the unemployed people, either they are untrained young people, or old people whom industry won't employ, or other workers who are not trained for available jobs. Therefore, let's train industry not to discharge these older workers, and let's train the younger workers and other unemployed workers, fitted for work."

Well, if there aren't enough jobs to take care of the young people and the older people who are willing and able to work, and the middle-aged people, how can training some of them, and training employers, take care of them all? The placard that ought to be hanging on the wall is this: Basically, in the American economy, people are not without jobs because they are untrained. They are untrained because they are without jobs.

This isn't true of everybody. You can find a local situation where there isn't a trained worker for this or for that. But what did we learn during wartime? I heard that the farm boys from my part of the country couldn't go into the steel mills and do the job. They did it, and they did it quick. The thing we learned was that the most precious commodity any economy has, is the adaptability of human beings. It's amazing how quick a human being can be trained. Of course, nobody can be trained to be an Einstein. But training for jobs? This is not the real problem.

Broadly speaking, if the labor force is growing about a million a year, the new people are coming up from among the young. If the economy does not grow enough, they don't get the jobs. These young people have been to school, but they haven't been trained in industrial work. So some economists look at these young people and say, "All these unemployed people are untrained. It's a problem of training. Just train them and they'll get the jobs." I'd like to send some of these training enthusiasts out to Michigan where there are hundreds or thousands unemployed, and see what they would train them for. To go into the automobile mills now? The steel mills? Agriculture? Running elevators in buildings? Typing? You cannot answer that by saying, "Well, I know a situation down in Texas where they needed four mechanics and the mechanics weren't there."

This isn't the way to look at an economy. We will never meet this economic problem unless we create new jobs to replace jobs which disappear, in addition to new jobs as the labor force grows. We are going to have to have fewer people in agriculture, even if we get the bigger distribution of foods and fibers which is desirable. The advance of technology is so rapid in the steel plants and the auto plants that jobs in these industries cannot increase as fast as output in these industries. So we need to stress other areas of job opportunity--housing, urban redevelopment, schools.

What I am getting at is that, we make a long-range analytical budget of our total needs and resources, we find that the composition of job opportunity must change constantly. We are not going to have, 10 years from now, the same percentage of the labor force in agriculture or in steel as in the past. But we need to provide unfolding work opportunities, for things which are needed, large enough to absorb the whole labor force. Therefore, if the labor force were 75 million, and we allowed for frictional unemployment of about 3 percent or about 2.25 million, then we would need almost 73 million jobs, not 70 million.

In the overall, we can't have overproduction, because the needs of the country are enormous; they are unlimited. On the public side, I don't even need to mention these needs here. On the private side, there are about 11 million multiple-person families in the United States with incomes of less than $4,000 a year, and more than half of our old people living alone have incomes of less than $1,000 a year from all sources. There is tremendous room in the United States for the lifting of the standard of living of the American people, which I say is a legitimate and a fine objective for any society. The Russians and the Chinese are going to lift their living standards. They will be competing with us on that front 10 years from now, just as they are competing with us now on other fronts.

We've got limitless markets within our own borders, not to speak of overseas, to take up the new technology. But we've got to plan for it. I agree as to the need for retraining if it is related to a budget of projected job opportunities. If we had a training force of a million Federal employees, and sent them all over the country, they would still have to know whom they were going to train for what. And they'd have to know whether the economy five years from now is going to have more people in the steel industry or more people in the electrical industry. What would they train them for, otherwise? The training program has to be a byproduct of economic analysis. Until you have long-range planning, you don't have that.

QUESTION: In some of the early discussions here at the College, we heard some interesting views on the national debt, most of them to the effect that it's a virtue. I would like to know, in your long-range planning and thinking, if you consider the ultimate retirement of the national debt. I'll go one step further: What's wrong with having a surplus?

MR. KEYSERLING: So far as debt is concerned, an economic system like ours, which I favor entirely, has debt, and the expansion of debt as one of its essential and prime characteristics. To be sure, the debt can expand too fast or to slowly, just as anything else can expand too fast or too slowly. This is a matter of keeping developments within the modes of sensible economic development on an equilibrium basis. But an economy like ours should have a bigger debt when it's a 180-million people nation than when it's a 120-million people nation.

This is standard, and I won't even elaborate on it. There is this question: Why, since debt represents saving and investment, is the expansion of private debt by definition good, unless you can prove in a particular instance that it's bad, and the expansion of public debt bad, unless you can prove it is good in a particular instance? I don't go for this dichotomy.

I am for what we call a free-enterprise economy, and most of our economy is free private spending, and I'd like to keep it that way. My proposals for the expansion of the Federal budget are for its growth in a growing economy, not for a growing proportion of Federal outlays to the use of the whole economy. But I refuse to say that the sound way to finance a private plant is by borrowing, but that the sound way to finance a public school is by paying as you go, or that the sound way to finance a highway is by paying as you go. There is no intrinsic sense in this dichotomy.

I think that our economy needs a growing private debt and a growing public debt, soundly financed--and a growing debt does not mean that it's not soundly financed. Our most prudent businessmen and financial people look into the papers, and, when they see that private debts are growing, they say our economy is on its way again. But too many of them are arbitrarily afraid of a growing public debt per se.

I do agree that, in times of high pressures upon our resources, when genuine classical inflation is rampant, we should try to run a surplus in the Federal budget. But we seldom have much of this type of inflation, except during wartime. We haven't had this type during the past eight years. The inflation during the past eight years--and there has been some--has been due to entirely different causes.

We have had the consumer price index going up to higher levels, but this has not been because our plants and our stores and our farms have been pressed by an overdemand for consumer products. This inflation has been due to various specialized reasons in the economy, which need to be handled by specialized policies, not by general fiscal policy. In other words, we can't handle this by having a budgetary surplus of $3 billion as against a budgetary deficit of $3 billion. There is no little or no correlation between the recent inflation of the Federal budget.

I think one of our big jobs is to get a sensible, unemotional attitude toward public and private debt. Both of them have to grow with the economy. They shouldn't grow too fast relative to the growth of the economy. We should not substitute growth in debt for growth in real production. To take consumer credit as an example, if the growing consumer credit is merely a fair portion of growing national income, that's fine, if we are using an excessive expansion of consumer credit to support an inadequacy of income, that's another thing. The same principle applies to the public side.

This problem is perfectly susceptible to analysis and sound solution. But it is not susceptible to solution by treating either private or public spending or private or public debt as if one belonged in the good camp and the other in the bad camp. We have, throughout our history as a nation, had intelligent private and public spending, and foolish public and private spending. We've made mistakes in both, and we've done great things with both. They've got to be brought into a balanced relationship as we move forward.

QUESTION: Mr. Keyserling, in our studies here we have become aware of the fact that foreign competition has resulted in some part of our capacity's moving overseas to take advantage of the cheaper labor. I have two questions: To what extent has labor priced itself into unemployment? If our local capacity were fully utilized, with the higher labor price, who could afford to buy the increased output?

MR. KEYSERLING: I'm going to begin to answer this question by talking about the gold and the balance-of-payments problem, because the two are really related, and both serve as illustrations of the same thing. A very large part of what we have heard and read in recent years, and especially in recent months, about the gold problem and the balance-of-payment problem, and pricing outselves out of foreign markets, is in my judgment hogwash. This illustrates our tendency as a nation, except in wartime, to indulge in symbols, to let these symbols serve as shields--gold shields, not iron shields--behind which certain limited interests advance at the expense of the Nation as a whole.

Let's take the gold and balance-of-payments problem first. I believe that the last Administration used the gold scare, as it had used the inflationary scare, in order to negate many of the great purposes which we needed to fulfill as a nation, including economic growth, on the ground that these purposes would be inflationary. Incidentally, this caused more inflation, because it was based upon a wrong analysis of the causes of the kind of inflation we were actually experiencing and the new Administration has been too prone, in my opinion, to make the same mistake.

Now let's illustrate this a little more carefully. We are not in a situation where, just as it was said a few years ago that because of inflation we couldn't have the armaments we needed or the production we needed--in fact this was said even during the Korean war, when I was conducting a battle within the Administration on this subject--so now it is said that we have to go slow on a substantial part of the new frontiers program, neglect a substantial part of the full-employment problem, and neglect a substantial part of the priorities of needs problem, because of the gold and balance of payments problems.

It is said that, because of the gold flow to other countries, we have to slow down the rate of economic growth and the rate of spending and not abate the tight money policy. Why haven't the economists who say this done a very simple thing, which I have done? I have attempted to correlate the gold flow with economic condition of the United States. The gold flow and the balance of payments are entirely separate things.

In 1958, under recessionary conditions, we had a very high unfavorable balance of payments, and a seriously excessive gold flow. In 1959, with the economy moving upward, the unfavorable balance of payments was still higher, but the gold drain was small. Then, in 1960, as a recession set in again, we were again subjected to a tremendous gold flow.

Why? Because much of the gold flow represents the attempt of those who hold short-term claims against us to translate these claims into gold. This occurred, not mainly because of differentials in interest rates, which is the classical theory, but because of the outlook for profitable investment. Money is looking for investment, and money is looking for profit, not just for an interest-rate differentials.

When it became apparent in 1960 that the American economy was sinking into the fourth recession since 1947, and the third since 1949, and that the American economy was in a profit squeeze, and that the American economy had 5 million unemployed, and when people were saying it was going to get worse before it got better, and when the American economy had tolerated a 2.5 percent growth rate for eight years while Western Europe was doing five or better and some other countries were doing eight or better, the smart, short-term money thought that there was something else which was better to hold than American dollars, namely, gold.

This isn't a theory. This is supported by facts. Therefore, just as the inflation in the United States in recent years, as I have pointed out here before, was caused not by overpressures upon the economy but by underpressures upon the economy, being an inefficiency inflation resulting from low operation, not a high-speed inefficiency resulting from excessivly high operations as in wartime, so the excessive gold flow represented an analogous problem.

Therefore, the first step toward protecting gold, and toward protecting the American dollar, would be the most vigorous and speedy policies to restore full employment, full production, a higher rate of economic growth, and adequate profit returns in the United States. Yet in the queer, upside-down nature of current economic policy, we are now hearing that we can't do those things because of the gold problem. That's item one on the gold problem.

Item two on the gold problem is that we shouldn't be tied to gold in the way we are, because the world's supply of gold is increasing only 1.5 to 2 percent a year at most, and, roughly speaking, at least in countries that operate under a price system, as free countries do, there must be an expansion of the money supply somewhat comparable to the rate of economic growth. Therefore, if we want a 4, 5, or 6 percent rate of economic growth, we need a 4, 5, or 6 percent rate of expansion of the money supply, through the banking system. And, if we need a 4, 5, or 6 percent expansion of the money supply, this poses unnecessary difficulties when the money supply is related in one way or another, to the gold supply, which throughout the world is expanding only 1.5 or 2 percent a year.

In other words, we have got our money system tied to a gold anachronism, a commodity which really does not have very great intrinsic value any more. When we are competing with powers who recognize real wealth, we can't afford to cramp ourselves with gold in this way. It's no answer to say that the Russians also are acquiring gold, and are also using it in the world. Sure they are. If we want to be so silly as to attach a ridiculously distorted value to a commodity which they can have and use against us, so long as we attach that value to it, they naturally take advantage of our folly. They know that gold has no great real value. They are merely using our own self-imposed liability against us.

So we ought to change the ratio of our gold supply to our bank reserves, which are a base for our currency expansion. We ought to change it fast. Then we ought to get rid of the gold reserve idea. Some of the respectable bankers in the United States, like Mr. Alexander, the head of the Morgan Guarantee Trust Company, and now Pierre Jacobson, of the International Monetary Fund, and various others, are proposing something like this.

Then we come to the unfavorable balance of payments problem, an entirely different thing from the gold problem. This ties in with the problem of foreign competition. Our unfavorable balance of payments is not in trade. We have seen stories in the papers, even today, emphasizing again that we have had a tremendously favorable balance of trade in 1960, as a whole, and are going to have a still more favorable balance in 1961. In other words, we are selling more goods and services to other countries than we are buying from them. We are occupying a larger part of the trade markets of the world than we did before World War II. I doubt whether we can sustain this position because, as other countries industrialize and work their way out of poverty and degradation, we can't expect to hold the share of world trade that we held immediately after World War II, when they were either decimated or underdeveloped. This is not a sound and safe nor reasonable policy for us.

We can and should expect to have a larger absolute amount of total world trade, if the total expands in a viable world economy--a larger absolute amount but not a larger share. So all this talk about our solving the unfavorable balance-of-payments problem by getting a larger share of world trade, through improving our price position relative to that of other countries, seems to me utterly unrealistic, and even if we succeeded in doing it, we would merely put the other countries back into the disadvantageous positions where they were just after World War II, we would be defeating our own policies of trying to help them after World War II, and we would be engaging, with our 6 percent of the population of the world which now has living standards 3 or 4 times as high as that of the rest of the world, in a predatory trade war trying to prevent the other countries from narrowing the living-standards gap.

To repeat, our unfavorable balance of payments has not been in trade. It's been in the fact that our military investments overseas, plus our loans and grants to underdeveloped countries, plus private capital investment overseas, plus our imports, have been more than what we have earned from our exports of goods and services.

This kind of unfavorable balance of trade will have to continue for some years ahead, because it is in the very nature of the international situation and the very nature of the relationship between the American economy and the other economies of the world. If we don't want to do this, then to be logical we should say we are no longer for an international policy of free aid to India, no longer for an American capital flow to the underdeveloped countries, no longer for bearing our fair share--whether it be smaller or bigger than it is now--of military establishments overseas.

In other words, we cannot do the other things we are deliberately doing now, and yet have a favorable balance of payments right away. People say, "Well, how long can we afford to run an unfavorable balance of payments of $2, $3, or $4 billion a year?" Well, if we tie it to the gold problem, as we do now, we are in a real fix for the reasons I have given. But if we clear up the gold problem, the real question is this: How long can a nation which has a $500 billion national product, and ought to increase it by $25 to $30 billion a year, afford to run a deficit of $2 or $3 or $4 billion in its international payments accounts? The answer is, indefinitely, if we need to, in terms of our real resources and their efficient use. This gets back to my point about national use of our resources in terms of real wealth, and not in terms of a superstitious kind of bookkeeping which becomes even more ridiculous when you tie it in with gold.

In summary, our trade position has remained favorable, perhaps too favorable, in terms of world adjustments. Our international balance-of-payments position has showed a net deficit for a few years, and has to show a net deficit for another few years.

The gold situation has been bad, but not as bad as the clamor. And it has been bad for reasons that we can cure only by cutting loose from gold, not by attempting to solve it in terms of gold.

We have not priced ourselves out of foreign markets. Some people are producing some things cheaper in real terms than we are. But this has been misused as an excuse for our bad economic performance in the United States--blaming our troubles on foreign markets and wages and prices overseas. We produced 9 million cars and trucks in the United States in 1955. We produced, let us say, 5 or 6 million in some later years. That's a differential of 3 or 4 million. How could an average importation of 200,000 foreign cars a year from other countries blot out the sale of 4 or 5 million American cars in the United States? Our steel industry has been operating for a year at 50 percent of capacity. How could this be due mainly to an importation of steel from Western European countries, which altogether have a steel productive capacity of not much more than our operative steel capacity at 50 percent?

In other words, the steel that has come into the United States, and the automobiles that have come into the United States (quite aside from the fact that they have been more than matched by our exports to other countries and that if we had not had these imports we would not have had these exports) have not been largely responsible for the low rate of economic growth in the United States, for the high levels of unemployment, nor for the bad policies contributing to this. I object to trying to find a scapegoat by exacerbating American opinion about worldwide competition.

Now, there are some limited items of imports which have worked very hard against some small industries. Therefore, we should have a national program of absorbing this cost on a nationwide basis, by doing something to soften the lot of these particular industries. But we've got to have trade with the rest of the world.

Finally, on the question of wage rates, the fact of the matter is that, while wages may have gone up too much in dollar terms, because prices have risen so much, wages in real terms have lagged behind the portion of total consumption which must be absorbed by wage earners, plus consumption by other groups, plus public consumption, to keep our industries fully occupied. In other words, our prices have been too high relative to our wages in our basic major industries, as illustrated by the fact that in the steel industry the break-even point is 40 percent or less.

No industry can fairly claim that its prices have been forced up by excessive costs, including wage costs, when it breaks even at 40 percent, and makes a profit at 50 percent, and makes a huge profit at 60 percent operation, and makes the biggest profit on record at 70 percent operation, so that it really doesn't care much about unemployed plant and manpower in the industry. This is not in the American tradition of a sound pricing policy. It is an exorbant pricing policy, which has been one of the factors in the imbalances within the American economy that I have been talking about.

Now, again, I may be wrong on some of these things. But my conclusions are based upon certain kinds of factual analysis which I will be glad to show anybody. I want the people who talk about wages pricing us out of foreign markets, the people who talk about foreign competition, the people who talk about the balance-of-payments problem, and the people who talk about the gold problem, to give us a genuine tableau of how the economy is working and how these things have happened. As soon as they start to do that, they will scratch their heads and realize that much of what they have been saying is not in accord with the facts.

COLONEL COLMER: Mr. Keyserling, thank you very much for an excellent lecture. On behalf of the Commandant, the faculty, and the student body, we are glad you came back again this year. Thank you very much.

(12 July 1961--5,400) O/msr/dm