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THE POTENTIAL OF THE AMERICAN ECONOMY

Mr. Leon H. Keyserling

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Reviewed by Col B. N. Smiley, USAF on 29 November 1963.

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

1963 - 1964

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CONTENTS

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Reviewed by: Col B.N. Smiley, USAF Date: 29 November 1963

Reporter--Grace R. O'Toole

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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THE POTENTIAL OF THE AMERICAN ECONOMY

18 November 1963

GENERAL STOUGHTON: Gentlemen: Our unit of instruction on Economic Policies for National Strength would be definitely incomplete without hearing from our speaker this morning, Mr. Leon H. Keyserling, a well-known economist and attorney.

Mr. Keyserling has been prominent on the national scene many times in his career, of note being his service as Chairman of the Council of Economic Advisers during the Truman Administration.

In spite of the demands on his time from the many responsible positions he has held, Mr. Keyserling has always taken time to come to the Industrial College to be of assistance to us here in our program. In fact, his appearance today is his tenth appearance at the Industrial College.

It is a distinct pleasure to welcome Mr. Keyserling back this year and to present him to this Class.

Mr. Keyserling.

MR. KEYSERLING: I am always glad to get back here. I think this is about the 11th time. I have been hoping against hope in the interest of the country that my theme would run out, namely, that we would get America moving again and begin to solve some of these problems that have been worrying me for so long, but the way things look now, I would expect that I have some years to go.

I am pleased at one sign of progress. I believe that the names of the talks which led up to this talk have been changed from something like Stabilization Problems to American Economic Strength Problems, which is in itself a very desirable shift, because the great problem of an economy is not stabilization; the great problem of an economy is movement. A pier is stabler than a boat, but the boat takes you somewhere and the pier merely receives the boat. This is very often forgotten in the course of a discussion of economic problems.

While I recognize that, because of the nature of this institution and, indeed, the very nature of the course, it points to or relates to the problem of building our economic strength as an aspect of maintaining our strength in the world as a military power, so long as we live in the kind of world where this is necessary, as you know, I have always taken the position, unlike some other economists, that I can never pretend to know what the size, scope, or composition of our military effort should be under any given set of circumstances.

I do know, however, that for us, as for every other country, our economic strength is fundamental to our military strength, and I do know from long experience, but I will not recount here--but which you may review if you will, by looking at some of the previous talks I have made here--that when a nation is making mistakes with respect to its economic strength, because they are mistakes of analysis, because they are mistakes of policy, because they are mistakes of habits of mind, they will carry over to the military, especially in the country where, as General

Washington said, "When we assumed the sword we did not lay aside the citizen," and where the ultimate budgetary and other decisions and economic policies which directly, as well as indirectly, affect the military picture are decided by civilians.

I don't want you to understand that I would like to see those ultimate decisions transferred to the military, but be that as it may they are decided by civilians, and the civilians are continuing to make many errors in this area because they are making many errors with regard to the general buildup of our economic strength.

The reasons why I say that we have been falling short in the buildup of our economic strength are by now too well known and too generally recognized--even aside from what I have been saying and will continue to say--for it to be necessary for me to emphasize them again. We all know that, when we came to a great watershed of change in national economic policy, which, under a free country is represented by a change in national government, in 1960, by that time it was fully recognized that we had had eight years of slow and inadequate economic growth, that this had cost us hundreds of millions of dollars in national production, that it has been characterized by a slowly but inexorably rising level of unemployed manpower and plant, and that it had been marked, not by a steady and slow growth rate but by a series of upturns, sideturns, and downturns, which I have called periods of inadequate recovery, stagnation, and absolute recession.

So in 1960 we made a declaratory judgment that we would get America moving again and improve its economic record. Unfortunately, a declaratory judgment is not self-executory, either in law or in economic affairs, and one of the first things I feel called upon to do, not in any spirit of criticism or recrimination but simply as one who has tried to recognize the obligation to call the shots as I see them, is to say that during the past 2½ years or 3 years there has not been any change for the better in our general economic performance.

Let's put it this way: The reason why we hear frequently now, and expressed in all sincerity, the statement that, if we don't have another recession within the next few months, we will be sailing on the winds of the strongest and longest recovery since goodness knows when, is very simple and may be illustrated by a simple analogy. If I were a doctor whose patient had been recovering from pneumonia for 18 months, I would not brag very much about the fact that it was the longest recovery on record, if others had succeeded earlier in getting the patient back to health in 6 months.

What has happened during this most recent recovery period is simply that we have gone longer without having another recession, but we have also gone longer without getting back to anything approximating the full use of our resources. In other words, if one examines the cyclical movements since 1953, to which I have been calling so much attention, the upturns after the recession of 1953 and the upturns after the recession of 1957 were very much stronger and swifter than the upturns after the recession of 1961, and the earlier upturns carried us back much closer, if not completely, to that full use of our manpower and labor force which represents economic health. In the cyclical process, since we have not solved the problem, the upturns came faster and the next period of stagnation therefore came sooner, and the next recession came sooner.

Well, it seems now that we are well on our way to having a longer period between the two recessions than we had twice previously, since 1953, but at the expense of having less of an upturn in terms of getting back anywhere near toward a condition of economic health. So that what we are really spreading out is not a period of upturn but a period of stagnation, and this is really not something to brag about very much.

Let me illustrate that by just a few figures, lest one think that it is merely a theorem. A mistake has been made rather frequently of thinking that some things that I have said here have been a mere theorem, but, unfortunately, a theorem that today has turned out to be an accepted observation of tomorrow. It was a theorem when I said here in early 1961, when there was high talk of getting unemployment down to 4 percent by early 1963, that in 1963 I thought that under the policies then in process of development we would still have, give or take, close to 6 percent unemployment in 1963. It was a theorem when I said this in 1961. It isn't a theorem now, because now the same policy-makers who in early 1963, when unemployment was 6 percent, said that they had every expectancy that their policies would get unemployment down to 4 percent by early 1963--which is a 50 percent reduction by 1963--are now saying hopefully but with less certainty that, if they get the tax reduction and various other things which are still in a state of animated suspension, they hope that unemployment will be 5 percent by 1965 or 1966, which is quite a shift in the goal, although not much of a shift in the program.

To indicate why I say that this latest recovery has merely been slower and therefore has taken longer to get us to the point where it will culminate in another recession, let me read you just a few figures. What I have done here is to plot the rate of economic growth by 12-month periods, beginning with the first quarter of 1961, when the recovery from the latest recession commenced. In other words, my first period is 12 months, from the first quarter of 1961 to the first quarter of 1962. My second period is from the second quarter of 1961 to the second quarter of 1962--and so forth through the second quarter of 1963. I'll say something in a moment about the third quarter of 1963.

In every single one of those successive 12-month periods, each one beginning months later than the previous one, we've had a declining rate of economic growth without exception. From the first quarter of 1961 to the first quarter of 1962 it was 7.3 percent. For the second quarter of 1962 to the second quarter of 1963 it was only 3.3 percent, or only half as high--a great deal less than half as high. The indications from the third quarter of 1962 to the third quarter of 1963 are very close to the immediately previous 12-month period--certainly below 4 percent.

So that what we've had during this period of 2½ years is a constantly declining rate of economic growth or a constant projection of increasing economic stagnation, plus the fact, as I intimated earlier, that during the first of these 12-month periods and during the second, when the rate of growth was 7 percent or 6 percent, it was much lower than the rate of growth in the first year or year and one-half following the preceding recession since World War II, and therefore the so-called spurt was a less-active spurt and left us at its peak with more unemployed plant and manpower than the spurts preceding the earlier recessions. For example, after the recession of 1953 we grew at 9 percent or something like that for a year or two, as against this 7 or 6, and then we did not go so rapidly into stagnation.

So it's a mighty poor record during the last 2½ years, not a good record at all, not worse than the record earlier but not any better, and representing no fundamental solution to the problem. This is also indicated by the data on where we stand now. As we all know, and as proved positive, we haven't been making any headway of appreciable consequence in the last year or so. If we have had a recovery from the first quarter of 1961 until now, which is almost 3 years, and if the recovery is quicker, as some of us have been told, during the last year, why is unemployment now higher than last year, and why is the average higher during the first three-quarters of this year than during last year? The recovery movement that has lasted so long and is sailing us on the winds so fair, and accelerating so nicely, certainly ought ultimately to reach the point where it begins to reduce idle manpower and idle plant as a percent of the civilian labor force and as a percent of our productive capacity in being.

So what we really have again is the statistical legerdemain of measuring the health of the economy by the absolute thermometer of production and employment and not by the relative of how close we are to full utilization of our productive power in being, which is the very point that in 1960 we recognized so well, when we were turning our eyes backward to critize the powers that had gone before. I don't see why we can't turn the microscope introspectively upon ourselves and be as candid in examining our own performance as in examining the performance of those who preceded us and whose record we promised to better.

You can see that I say "we," and that I can't divorce myself from my deep attachment and lifelong affection for the party now in power.

The fact of the matter is, as I have said, that unemployment now is higher than it was last year and our idle resources are higher than they were last year. Therefore, we have gone backward, even though in absolute terms we can cite figures to the effect that our national product is $100 billion than it was 3 years ago. Well, President Eisenhower could cite those same statistics in 1960, and we criticized him for so doing, because, although we were higher as measured against a straight line, we were lower as measured against the normal projection of our growing productive resources.

This is the only thing that the whole problem of economic growth is all about. So where are we higher? I'm a little concerned also about the understatements as to the size of this problem--the figure of 5.5 or 6 percent of the labor force unemployed. When I was talking here a few years ago, I pointed out ... . the full-time equivalent of part-time unemployment. In other words, 50,000 men laid off for half of the week, instead of 25,000 laid off for the whole week, were not counted as unemployed. I said it's the equivalent of full-time unemployment of 25,000. Well, ultimately, now, after long efforts, this full-time equivalent of part-time unemployment is revealed in the economic indicators, and therefore it is counted by the Government, but it is not articulated by the Government, because we still hear talk about 5.5 percent unemployment. Well, when you take their own figures, including the full-time equivalent of part-time unemployment, the unemployment is about 7 or 7.5 percent of the labor force, and not 5.5 or 6 percent.

Now, there is another category of unemployment which I haven't been derelict in talking about, and that is the concealed unemployment. Concealed unemployment results from the fact that when the demand for jobs is scarce or nonexistent a lot of people don't keep on looking for jobs every day in the big areas, where most of the population is, and as they stop looking for jobs because they have been turned down day by day and month by month they are no longer counted as unemployed, and therefore the situation looks better as it gets worse.

Anybody with the simplest mathematical training could compare the size of the growth of the so-called civilian labor force with the growth which was predicted two years ago, based upon the large numbers of births shortly after World War II, and I suppose those people are still here who were born then. Of course they are reflected in the fact that the rate of unemployment among the young people is 3 or 4 times as high as among the civilian population generally. So they're here, they are answering "present." One can make that simple subtraction and see that there is concealed unemployment.

Now, when you make a fair allowance for that, the level of unemployment now is about 9 percent, and 9 percent unemployment, which correlates very well. Incidentally, you have a curious feeling after you've talked about these matters for so many years to see them finally discovered, just like Columbus getting back to the Old World and being told a number of years later that somebody discovered America. We now find some well-known academic economists some way or other getting a big play because they have discovered that unemployment now is realy 8.8 percent--my estimate is 9 percent, but that's the same thing-- by taking these factors into account. Everybody is excited about this. Well, it has been obvious for a long time.

Now, when we correlate the 9 percent unemployment with the amount of idle plant capacity, it correlates pretty well. The idle plant capacity is about 50 percent, and this correlates well, because we have a lot of under-utilization of labor in the plant. They are not counted as unemployed, but this is one of the explanations why the amount of plant idleness is greater than the amount of counted unemployment, even the way I could it. I'll come to the significance of that in just a moment.

That's where we are now. We have a more serious problem, and of course this has cost us--to repeat myself--over $400 billion in national production over the last 10 years. If that lost production had been attained it could have been allocated to the things we need most in the Nation, and I'm not going to argue here whether it's national defense or this, or that, or the other thing. The fact is that we didn't have it and we couldn't use it for anything. It has had a very heavy effect upon our budgetary position, which in turn has a very heavy effect upon doing some of the things we need to do, when as a nation we are committed, rightly or wrongly, to a balanced budget.

I'm not interested in arguing here today whether or not we should have a balanced budget but rather in pointing out that, if we had had an adequate rate of economic growth over the last 10 years we could, at existing tax levels, and even with some tax reduction, and with a considerably higher level of Federal expenditures than we've had, had a net difference of $52 billion or so in the Federal Budget, which I demonstrated in one of my recent studies. So you don't have to be for deficits in order to be for economic growth.

Now, the more important question is where we are going. I don't think we are going anywhere. We haven't gone anywhere during the last 2½ years to speak of, and I don't think we are going anywhere over the next 2½ years, or the next 5 years, except toward a continuation of the high-level stagnation, in other words, a continuation of a low rate of economic growth.

You can't sweep the unemployment under the rug, so to speak, indefinitely. Just as in 1963, even by the conventional measurement, we have unemployment twice as high now as 10 years ago, which is an inescapable fact even on the official account. It's 5.5 percent or 6 percent now. It was less than 3 percent in 1953, althougn we had a recession beginning in the middle of that year. So that any way you take it the unemployment has doubled in 10 years. I'm giving the defenders the break, because I'm comparing a base year when we had a recession with the year where we are now saying we have been recovering for 2½ years and are on the winds of the greatest recovery on record. So I'm giving them all the breaks, and it's still twice as high, measured as a percent of the civilian labor force. Measured in numbers it's more than twice as high.

I think in the next 10 years it will be twice as high again, unless we reexamine the policies under which we are operating. Now, what's the difficulty with these policies? Some of the difficulties I have already intimated. Let me be a little more specific. The first thing that you've got to do to deal with the problem is to identify its size. In other words, if you want to send an army across the Atlantic, you've got to decide the number of people you want to send and the logistics of getting them there and how much material it takes, roughly speaking.

The first great difficulty in dealing with the current problem is that the economists, and through them their superiors, have persistently, to my mind, in the face of all the facts, been unalterable in their determination to define the problem as about half the size that it really is. If you do that, how can you solve it? Let's get specific. We have been hearing for a few years about the target of a 3.5 percent economic growth rate. What is that based on? This is regarded as the norm. This is set forth by the Council of Economic Advisers as the amount by which the economy needs to grow to absorb from year to year the incremental growth of the labor force and productivity, in other words, the amount of growth required to hold unemployment about constant to about whatever level it is. So you hear a great deal of talk about this 3.5 percent figure. The 3.5 percent figure is meaningless for two reasons.

In the first place it is utterly irrelevant until you recover, because, if you have a deficit of $40 to $80 billion in your national production and an unemployment rate of 6 percent or 9 percent, you don't need to grow by the 3.5 percent. You need to grow about 9 percent until you recover and then you start growing at the 3.5 percent. So all the talk about the 3.5 percent, even if it were a proper measurement, is measuring the wrong thing. It has no relevance until you recover, because, if you were to grow at 3.5 percent from where you are now, and if they were right that this was merely enough to absorb the increment of the labor force and the productivity, you would hold unemployment and unused plant at where it is now. So the whole talk about 3.5 percent is obvious nonsense from that point of view.

In the second place it is wrong, although not nonsense, for a much more important reason, that it is tremendously underestimating the growth in the labor force and the productivity. I have been saying this for a long time and it's just becoming apparent. The 3.5 percent figure is based upon an assumed normal growth in productivity of about 2.5 percent and in the labor force of about 1 percent, and therefore, roughly, you get 3.5 percent.

I've pointed out that if you go all the way back to 1920, that's far enough, except for the economists who want to make averages going back to 1860, which are even more irrelevant. Even if you go back to 1920, we have never had a period in American history where reasonably full employment was maintained at anything like a growth rate of 3.5 percent. During the 1920's, when we maintained reasonably full employment under conditions of disequilibrium which gave us a big crash at the end, to be sure, the economic growth rate averaged about 4.5 percent, or 4.8 percent. This was also true of later periods.

One of the most fantastic things is the underestimate of productivity growth--and I've called this to the attention of the group before. What the economists do is divide the amount of labor input into the amount of output and they say that's the productivity figure. That's silly, because, if a steel plant is operating at 50 percent of capacity and employing 75 percent of the workers, you have an underutilization of these workers which results in a low productivity figure, when you figure it this way. This has nothing to do with technology, which is the real problem. The productivity potential is advancing as fast as your technology is improving, and this is the real problem.

Now, the way this manifests itself is very simple. When you begin to have a recovery at, let us say, the 3.5 percent rate, and when there is more pressure upon your economic resources than there was before, you start using the labor force more efficiently, and the productivity starts moving back toward the real potential--in other words, the actual productivity, resulting from dividing the working labor force into the output--and begins to catch up and reflect the real technological change in productivity. Then the economists rub their hands and say, "How is it we are getting more output? We're getting a rise in the economy but we're not getting less employment." The answer is very simple. The rise is being taken up in the latent productivity potential that was there all the time, and which I have been trying to call their attention to. This again is beginning to come out in the figures during the last year or so. The Labor Department is telling us that the productivity growth rate in the recent years has not been 2.5 percent or 3 percent or 3.5 percent but at least 4 percent and maybe 4.5 percent, which I have been saying all along.

Even if it is a little high--and of course some of the economists say that it is higher during a period of recovery like this than it is going to be in the long run, and they're as wrong as they can be about that--it isn't going to get any lower unless we get into another recession. It's probably going to get higher much faster than any of them thinks, because there is a revolution going forward in our mass-production industries on this matter of technology and automation. It would be much safer to assume that it is going to be higher than it's going to be lower. But, even if they take it anywhere around the current 4 percent figure, and add to it a labor force, allowing for the concealed unemployment, this is also called for when employment opportunity increases. They wonder why, when the economy was moving upward, unemployment didn't drop much. The reason was obvious, too. They began calling some of the people out of the woodwork, and so the concealed unemployment was shown, and the unemployment remained just as high as it was before. In other words, when the economy moves upward it's got to start taking up this slack in available potential resources before it starts working down unemployment of plant and manpower. This is so simple that it ought to be seen by now.

What this all adds up to is that, if you are going to have a program to enlarge economic growth and to reduce unemployment, you have to define properly the size of the army and the logistics of the situation. This would lead to the conclusion that we need to aim toward an economic growth rate of at least 5 percent a year, and maybe 5.5 percent a year, after full resource use is restored, because you need the 5.5 percent to absorb the annual increment, and for the next year or two until you get back to restoration you probably need 9 or 10 percent.

Now, since there is no adjustment of the programs to these magnitudes, the programs would be quantitatively deficient even if they were qualitatively reasonable. It's perfectly obvious. It's perfectly obvious that, if you take the tax-reduction program and assign to it the stimulatory claims which the proponents of the tax reduction assign to it, it's a very, very small part of our growth needs if you properly relate the growth needs to what our growing productive potentials really are.

But the second and equally serious difficulty with the programs is not that they are quantitatively inadequate but that they are qualitatively wrong, which is a very serious matter, too. Why is this the case? I don't have very much time, and I can outline this only very briefly.

Let's take the tax-reduction program as an example. Why is it qualitatively wrong in large measure? First, it is qualitatively wrong because, when you look at the apportionment of the tax reduction among the various factors, you find far too much of the tax reduction going where it is not needed, and not nearly enough of it going where it would be helpful. In other words, take the corporate tax proposal, and take the portion of the personal tax reduction which goes to the high-income groups--and I am not talking here of the social or ethical or moral aspects of the case, although I do believe that these have a place in the policies of a great nation, because I have always discussed it with the economists who say, "Oh, you are talking social policy; you're not talking economics." The ultimate objective of all economics in an intelligent society is social policy. What is our economy for?

But, putting that aside entirely and just looking at the economics of it through narrow gauges through which some people look at economics, isn't it a farrago that, with corporate profits higher than ever before, with retained earnings higher than ever before, with funds available for borrowing and investment higher than ever before, and with a prolixity and redundancy in all these areas, even with 15 percent idle plant capacity, they're taking a large part of the slender resources that we have, allowing for the national attitude toward the budget, and piling another few billion dollars on of tax reduction for the purpose of stimulating investment? Isn't it perfectly obvious that I say this as a friend of investment when I say that all the big corporations need is an ability to sell more, and that, if they could sell more, there is no insufficiency in their profits, there is no profit squeeze, and there is certainly no inordinate tax burden?

So we're directing a lot of this tax reduction where it will be largely wasted. I recently was challenged by the Treasury and a most amazing thing happened. I made some calculations of how much of this tax reduction would go to whom, and measured as a percent of income to show how much income increases different people were getting. I testified on that up on the Hill. And low and behold, my friends in the Treasury sent up a table which was designed to refute what I said. What did they do in the table? In the table they pointed out that I wasn't dealing with real income, that I was dealing with so-called adjusted gross income on which taxes are paid. That's the only thing I could deal with, because I don't have all the fine data on how many people are getting away with not paying taxes on part of their income.

So the Treasury, in the effort to refute me, made up a new table which showed people having bigger incomes after taxes than they had before taxes, if their incomes were high enough. The way they did this was very simple. They said, "The fellow has an adjusted gross income of a million dollars, and that's the figure Keyserling was using. Let's say he pays $231,000 in taxes. Keyserling thinks he's got about $760,00 dollars left. He's wrong, because this fellow has more than a half-million dollars in income on which he is not paying taxes. His income is really a million and one-half." So, when I took their own figures on income as they estimate it, and income on which taxes are paid and income on which taxes are not paid, what did it show? It showed that the person who they said had an income of a million and one-half dollars was paying a lower tax rate than the $25,000 family.

If this sounds fantastic to you, go and look at page 809 of Volume II of the hearings on the tax bill and you'll see what I am talking about. The million-and one-half-dollar family was paying 18.5 percent tax rate effective, as estimated by the Treasury--not as estimated by me--and the $25,000 family was paying 18 percent plus, or a little bit higher, and the $50,000 family was paying something like 23 percent.

In other words, the tax system was already profoundly regressive and this Treasury table completely explodes the whole idea that these people away up at the top are paying 91 percent marginal rates or anything like it, which some of us have known all along. The million-and one-half-dollar family is paying only 18 percent as estimated by the Treasury.

So why do you need to have a tax-reduction program which adds to their after-tax income more than anybody else's, for any reason?

The next reason why the tax-reduction program is wrong--although I am for some kind of tax reduction--is that, when you look at the unemployment problem, a lot of it can be solved only by programs which will not be expanded by virtue of a tax reduction. Let's take the very simplest example.

The fact that this is not recognized shows that the people who are talking about technology and automation don't know the first thing about what they're talking about. In the automobile industry, let us say, technology or productivity is advancing 7 or 8 or 9 percent a year. It is. In many other of our mass-production industries it is advancing extremely rapidly, and still more rapidly in agriculture. No kind of tax reduction or no kind of other policy can effectively expand the demand for these kinds of products enough to take care of the unemployment problem, because, if you want to take care of the unemployment problem, let us say, by the expansion of automobiles, sure, you can create a theoretical model that will do it. I can create a theoretical model that will take care of the unemployment problem by making peppermint sticks. But if you're going to take care of unemployment by expanding the demand for automobiles, you have to lift the demand for automobiles to 30 or 40 million a year, in view of the productivity in that industry, and obviously you wouldn't have anywhere to put the automobiles except in the ocean. What are we going to do with 40 million automobiles a year anyway?

This is true of agriculture and of steel and of chemicals, and of most of our mass-production industries. Therefore, most of your expansion is unnecessary. Sure, you can increase the aggregate demand and prevent employment in manufacturing from continuing to decline at a rapid rate, but how are you going to get the 22.5 million new jobs that the President and everybody else is talking about? Incidentally, we say that 10 million of those must be jobs to take care of those dispossessed by automation and technology. So how are you going to get this by tax reduction which will cause people to buy another car a little faster and a little more consumer durables, or, if they are rich, to buy a yacht or go to Europe and increase our balance-of-payments problem?

In other words, to get the employment we've got to do some of the things that the Nation needs the most and that we can do enough of without boondoggling to overcome the rate of technological growth that provides jobs. What are these things? They are city rebuilding, clearance of our slums, mass transportation, education, health and the facilities that go with it, and national defense, if we need it, or international economic cooperation. But all these things require a combination of public spending and combined private and public programs; lower, rather than higher, interest rates; and looser, rather than tighter, money. Not one of them that has been used is accelerated to any substantial degree by scattering tax reduction among 190 million people, because they're not going to spend for those kinds of things. You don't get a school building built or a slum cleared or national defense increased or a hospital built or medical care brought within the reach of more people--only about half have that now--you don't get any of those things done by adding a little bit to the spending power of everybody. These are things we have to do as a Nation, and they're just as free as anything else.

My time is nearly up. I can give you only one example of that fact. First, we are underestimating the size of the problem grossly, just as grossly as a few years ago and with about the same results. Second, after underestimating the problem grossly, we are applying remedies ill attuned to the problem. I can just take the tax example, which is ill attuned for the two reasons I've given and for many others besides. This doesn't represent any great political genius, either, in view of the time it takes to get it through. My friends have told me that it is the wrong program and this is the only thing that is politically feasible. I haven't exactly seen the feasibility yet.

Finally, in order to appraise the size of the problem correctly and to apply the right remedies, you've got to have a national economic budget. This is called for under the Employment Act. The national economic budget has nothing to do with what government does and what business does. It has nothing to do with the respective division between enterprise responsibility and government responsibility. Government responsibility could be more or less under a national economic budget. What it does do is to quantify in relative peacetime, as you do in wartime, what your resources are, what they can produce, how fast you want to go, and what share your public economic policies play in this movement forward under a proper reconciliation.

In other words, you put the things together so that you can see what you are doing. This wouldn't say that the Government should regulate prices or wages. It would say that the Government's tax program, the Government's monetary program, the Government's housing program, and the Government's defense program should be reasonably related to the national economic budget and weighed quantitatively against what you are trying to do and tested against where you are going. This is called for under the Employment Act, yet, if the Council of Economic Advisers and the President did this, they could not possibly arrive at the kind of tax program we've got. They couldn't possibly arrive at the 3.5 percent figure, because the bare and ineluctable figures, when set forth in proper perspective, would show that this was wrong.

They're making economic policy on the basis of long-term averages which don't relate to the new technology and on the basis of classical economic principles that have never described how our economy worked and they certainly don't describe how it works today, and certainly, in any event, should not be allowed to describe how it should work in a free system which has to marshal that blend of freedom and decisiveness which the President himself tells us is necessary in the long-range contest not only with the totalitarian states but also with the states of Western Europe which are compounding a reasonable blend of freedom and decisiveness.

Thank you very much.

COLONEL AUSTIN: Gentlemen, Mr. Keyserling is ready for your questions.

QUESTION: Mr. Keyserling, would you give us your estimate on how much government spending you think is necessary?

MR. KEYSERLING: Well, you cen't give any one precise dollar estimate of how much government spending is necessary. The important point I am making is that the level of government spending should derive from a rational portrayal of the whole economy in action and a consistent policy. In other words, I wouldn't say how much government spending there should have been during World War II, but I know how it was arrived at, and I know that, if it had been arrived at the way we arrive at it now, we would have lost the war. This is quite a different question from how many dollars it should be. That's the important thing.

It is also true that in peacetime, just because you're not in a war, there's no reason why this rationality should not apply in the determination of your basic policies. I am talking about a method of economic analysis, not whether you should have price control in peacetime or whether you should draft men in peacetime. The principle of rationality as to how your level of government expenditure should be determined is the same for all the time. If you learn something during wartime there is no reason for abandoning it in peacetime, any more than if you learn about a better anesthetic in wartime and abandon it in peacetime on the ground that we are not at war.

So as not to duck the question--I don't think I have ducked it--

insofar as you want a more definite answer, I think that, now, on the basis of my models for the economy, the level of Federal spending ought to be somewhere between $5 and $10 billion higher than it is.

QUESTION: What has been the picture of resale prices on the cost of living during the past two years, and what do you think the effect will be on the cost of living if we have a 9 or 10 percent increase in the growth of the economy?

MR. KEYSERLING: In the first place, my studies of price movements, particularly my study called "Inflation--Cause and Cure," show that in the American economy there is no positive correlation between the rate of economic growtn and the amount of price inflation. In fact, the idea that there is a positive correlation is the carry-over of the classical economics in a time when empirical observation would show the contrary.

You all remember that when prices were rising so fast during the economic recession of 1957-58, and rising so fast during the low growth-rate period just before or just after that, the economists were rubbing their eyes and saying, "This is the paradox, this is the new inflation," and they were trying to find a new explanation of why the prices were rising faster during a period of economic slack. They could have read my book and have seen that there was nothing new about it and that I had foretold it. All I was saying was--and some of you may remember my analogy--that, if an automobile burns more gas going 90 miles an hour, which is too fast--it burns more gas per mile--and will also burn more gas per mile going 30 miles an hour, which is too slow, it achieves optimum efficiency at about 50 miles. The economy is the same way. If a price is administered in an economy where wages are made by collective bargaining, the group, short of a great depression, will try to compensate for the economic slack by a higher marginal return. Therefore your prices will rise faster under conditions of under-employment than under conditions of full employment, provided that the under-employment is not a real depression which, of course, will cause prices to fall--but it's too high a price to pay--and provided that the full employment is not the hyper-employment that you have in wartime.

So that, if we moved at a rational rate of economic growth and a fairly stable level, we would net less price inflation in the long run than under the kinds of ups and downs we have been experiencing. That's the first answer.

The second answer is that, relatively speaking, a small amount of price inflation is a far less serious problem than the tremendous economic and other losses involved in the staggering departures from full use of your resources.

QUESTION: You have cited a $400 billion loss by failure to use capacity. I am interested in such excess capacity as steel, chemicals, and petroleum. You have also recited on the other side shortages in education, medical care, and so forth. How do you translate the excess capacity in the excess area to the shortage area, where we have too few doctors and too few teachers?

MR. KEYSERLING: Exactly the same as in wartime on the fiscal-policy side, although not the same on the draft side. In other words, in wartime you make an economic budget of your resources and you make an economic budget of your main priorities, and then you change your tax policies and your monetary policies and various other policies to bring your resource use into line with your priorities and needs.

Now, in wartime you implement this by price and wage controls and by allocation of materials, because the shifts which you have to make in resource use are so extreme and have to be made so quickly, because more than half your product is being consumed in fighting the war, that you have to adopt a very drastic program.

I'd say that in peacetime you would not need nearly so drastic a program, but the principle is the same. In other words, if we made up an economic budget of our long-term priorities as a nation, that budget would include, among other things, the things that you mentioned. It would include how much excess steel capacity we had, and it would include how budgetary policy, which is a very important lever for the guidance of resource use, would implement the priorities as established within the confines of the resources available as said.

In other words, if you wanted more education you would spend more for education. If you wanted more slum clearance, you'd spend more for that, and you would reconcile it with your other areas of spending, and you would reconcile it with the kind of money policy, tax policy you had, and so forth. You also have many other implements to these adjustments besides budgetary policy. You have monetary policy, you have social-security policy, housing policy, regulatory policy. All of these should be brought under the guiding principles of a rationalized economic budget. You determine your targets and than you adjust your policies to them.

QUESTION: Regarding the personal-income tax structure that you propose, would you use it as a device to equalize income for all classes?

MR. KEYSERLING: No, of course not. I don't believe in equal income for all classes. I don't believe either in pretending that we have a progressive income-tax structure when, according to the figures that I have just examined, the million-dollar-a-year families pay a lower tax rate than the $25,000-a-year families. Either we should say as a nation that we want the million-dollar-a-year family to pay a lower tax rate than the $25,000-dollar-a-year family, or, if we don't, we should make the tax structure comply with what we say our objective is, and we certainly shouldn't believe the stories that the tax rates effectively of these high income levels are so great that we need to cut them in order to prevent them from being oppressive. There's certainly nothing oppressive when the million-dollar family, according to the Treasury's own table, is paying an effective 18 percent Federal income-tax rate. That's not oppressive. It has a bigger income after taxes than before taxes, because the before-tax income is figured after leaving out certain sources of income which don't enter into the before-tax income for the purpose of determining the tax rate. In other words, the adjusted-tax income on which you base your tax leaves out a lot of forms of income. So the Treasury comes up with a table showing that this million-dollar family has a million-dollar adjusted gross income and pays a certain amount of taxes, and has more left after it gets through paying income taxes than it did before in terms of actual income, so it is really paying a tax rate on the actual income of about 18 percent.

I would change that. I would make the tax system come a little bit closer to being as progressive as most people think it is and as it is supposed to be, and I would do this by closing some of the loopholes and by making the tax reductions more progressive than they are in the existing tax bill. I certainly would not start out with a tax bill that justified the distribution of a tax cut by saying that we are going to close the loopholes, and in other words saying that we are going to get rid of this 91 percent marginal rate and some of the other high rates, not because people are paying too much taxes in the upper brackets but because the rates are so high that they evade and avoid their taxes, and that we are going to lower those tax rates and make up for it by closing the loopholes so we'll have a better structure.

I certainly wouldn't, after saying I was going to do that, let a House Committee take out the loophole closing and leave the rates about the same, and then not make any effort as a great Administration under great national leadership even to tell the country that that's what happened and that I wasn't satisfied with this kind of tax bill. I'd try to get it straightened out or I'd say, "I'm going to veto the tax bill."

QUESTION: Would you expand your remarks, sir, to include the impact of foreign aid on our economy?

MR. KEYSERLING: Well, the impact on our economy of foreign aid is of two kinds. A good deal of foreign aid is spent in the United States, so that it has sort of the same effect as a public-works program, if the foreign aid is a gift. In other words, if the foreign aid is a gift, and if a large part of it comes back to expenditure in the United States and thus stimulates production and income in the United States, it has somewhat the same effect as a domestic public-works program--not exactly the same, because you don't get the ultimate public improvements, and some of the income is shared abroad. But it has in part that effect.

If the foreign aid is a loan or investment, it has the same effect in the long run as if the investment were made locally, because the ownership is private and it doesn't matter what the product is. In the long run, theoretically and practically, the interest or the profit returns to the United States. This is the difference between the long run and the short run, because in the short run the money flows out of the country before the repayment starts coming in.

This is why we have a large part of the balance-of-payments problem, because there is a conflict between the short-run flow and the long-run flow. In the long run the United States has been, now is, and will remain in a very favorable balance-of-payments position, but we have, for the reasons given, these short-run deficiencies, and therefore we ought to set up some international equivalent of what the Federal Reserve System was when it was an instrument of the Government, before it became a creature of the bankers. We ought to set this up on an international basis and isolate the balance-of-payments problem and the gold problem from the general operations of our domestic economy, because, the way it is now entangled with the general operations of our economy, we are letting the processing of a metal which really has no or little intrinsic weight value swing the whole elephant or donkey of a great, massive, $600 billion national economy.

This is just as ridiculous as if during wartime we needed to send a navy to the China Sea and had all the manpower and all the oil and all the chemicals and all the sailors and all the admirals to send the navy there, and if after sending it there we would have all the resources at home that we needed for our other purposes, and somebody got up and said, "All that is true, but we can't do it because of the gold problem." Such a person would be locked up. But he wouldn't be any sillier than the people who are saying essentially the same thing now. His reason would be that really, when the chips are down, gold isn't of very much value, and you've got to handle it in a way that doesn't interfere with anything you want to do.

If that's true in wartime, then it's true in peacetime--and it is true in peacetime.

QUESTION: Mr. Keyserling, you mentioned that at the present time we have about 15 percent idle plant capacity, and perhaps hidden and otherwise available, 9 percent, unemployment. Would you comment on how to get around the problem that much of the plant capacity is obsolete and wasteful and that management doesn't wish to use it because they would price themselves out of the market and couldn't sell the goods produced because of plants abroad, et cetera?. I realize that if it were used it would take care of the unemployment problem, but how do you get around this idea that it is not good enough?

MR. KEYSERLING: I'll give you a little practical example. During the last two years I was doing a great deal of work, as some of you may have noticed in the papers, on the railroad problem. I was opposing some of these gigantic railroad mergers, not because I'm against bigness as such but because implicit in the mergers was the declared intent of the giant railroad companies to cut back still further on their car-carrying capacities and on their locomotives and on their labor forces, and everything else. In the course of my analysis I said that, while some of these roads might be in over-capacity now relative to an American economy operating at 85 plant capacity and 91 percent labor utilization, we actually had a great shortage now of railway cars and other railway equipment relative to what we would need if our economy were restored to reasonable economic health, not to speak of what we would need if we grew as we should, and that the railroads, by moving in the opposite direction, were budgeting their plant capacity downward and thus were both propitiating and accelerating, as well as augmenting, the adverse trends in the economy, because what our great industries do interacts upon the economy.

Well, everybody laughed at this one, including maybe the Interstate Commerce Commission. And what has happened since? We get just a little bit of strain on our railroad capacities because of the need to move some grain, and I read in the papers that the ICC and everybody else is all worried about the shortage of freight cars. Now, if a shortage of freight cars is created by the need to move a little bit of additional grain in an economy that is 15 percent short of full plant utilization, and, according to my estimate $80 billion short of full production, don't we have a shortage of railroad facilities?

This applies exactly to this other question. What do we mean by obsolete plant? We simply mean the marginal plant that is not in use when you don't have enough demand to utilize fully and efficiently your whole plant. By that definition, if the economic slack should increase to 30 percent instead of 15 percent, and if you retired another 10 or 15 percent of your plant, you would soon be calling that additional 10 or 15 percent obsolete. So we call something obsolete when, on a marginal basis, it is less efficient than what we use when we are not using the whole thing, but this has nothing to do with a national point that it is more efficient to use the whole thing than it is to use 80 percent of it.

It is exactly the same way with the labor force. We hear now that the 9 percent unemployment, or 6 percent, or whatever it is, is unemployed because it is less efficient. We don't call it obsolete, but we say it isn't trained. It's too young, or it's too old, or the color isn't right, or the education isn't right, or the will isn't there, or something else. The fact remains that it is less efficient than the labor force being employed, because our management has enough sense, if they are going to have to fire people, to fire the less efficient people first. This doesn't mean that as a matter of national efficiency it's better to have them idle than have them working. They're two entirely separate things, and these two things get them completely confused.

It's the same with an army. Maybe if you need an army of 10 million men, 5 million are more efficient than the other 5 million, and it would be more efficient to have half of them go home. But the 10 million is more efficient than the 5 million, none the less.

It's the same with an economy, and that's the answer to most of this problem of idle plant capacity.

QUESTION: What factor was the rate of economic growth for the past 20 years compared with other times in history? It appears pretty spectacular to me. I don't understand how we can take the economic growth and study it for a one-year period and say that we are not growing. I really don't understand what we are looking for. The GNP back in 1940 was about #769, in 1950 it was $1884, in 1960 it was $3950, and in 1970 we expect it to be over #6000.

MR. KEYSERLING: Well, what we are looking for and what we are finding seems to be very simple. First of all, nobody is basing a conclusion of low economic rate upon what has happened during one year. What I am comparing is the rate of economic growth during the most recent 10 years, which has been about 2.8 percent, with the rate during the 10 years before that, which was about twice as high. I maintain that a 10-year period is a long enough period in which to start drawing some conclusions about what is happening to us, and that you don't have to wait 20 years. In fact, 20 years is too long, because, by the end of the 20-year period you have a few factors entering in that didn't exist at the beginning of the 20-year period. Ten years is plenty long enough.

Second, you have a perfectly practical test, because you do not draw the figure on what the appropriate economic growth rate should be from comparisons with other countries or from the kind of historical comparisons which you suggest. You draw it from only one thing. You want your economic growth rate to be high enough to make reasonably full utilization of your growing productive resources. Nobody can quarrel with that. If you have growing productive resources you want to use them, and if your human resources, which are the most important, have gradually been rising with respect to unemployment, and the unemployment of your human resources is twice as high now as it was 10 years ago and has been rising in a fairly uniform, chronic pattern, then you can say that your economic growth rate has been too slow. And you apply the same thing to the plant size and you can see that your idle plant capacity during the past 10 years or the past 5 years has averaged 2 or 3 times as high as what used to be regarded as the normative efficiency rate of un-utilization--that is, operation at 90 percent and so forth--and then you can say that your economic growth rate is too low.

So, first, it isn't based upon one year and it isn't based upon any arbitrary comparisons with the past. It's based upon an observation of whether you are growing at a rate that enables you to use your growing productive powers. And if it isn't enabling you to do that reasonably well, you ought to be growing faster.

QUESTION: Sir, there are those who have described your philosophy as being possibly somewhat ahead of the time. It has also been pointed out that there is quite a lag on the Hill in the understanding of these economic affairs. I wonder if you have made any estimate as to how long it might take you to overcome that lag and to gain the kind of understanding you would have to have to sell the kind of program you are talking about, assuming that you again were Chairman of the Council of Economic Advisers and had the President thinking your way.

MR. KEYSERLING: The only reason I am here is because I haven't been ahead of the times. I have been in Washington 30 years and, if one looks back to the things that I've stood for and fought for during the 20 years I was in the Government, one finds that practically all of them were adopted and practically all of them are looked back upon now by even those who opposed them as the reasons why the American economy is stronger now than it was 30 years ago. I was in the original fight for all the legislation that took place in the early and mid-thirties, and for the accent upon economic growth which everybody now is voicing, even if they are not responding to it. So I'm not ahead of the times.

We've simply had, for reasons I don't want to go into in too much detail, an accent of leadership which is too far behind the times. The remedy for that, the only remedy open to people in a democracy who show a profile of courage is to call attention to it.

QUESTION: Sir, would you take another look forward and discuss possible counters or solutions to the increasing industrial unemployment due to automation?

MR. KEYSERLING: The increase in industrial unemployment means that the main solution to the employment problem must come outside of the industrial areas where this is happening. That's what I've said before. Now, if you take the needed measures to increase aggregate demand among 190 million families you can help the level of employment in these industrial areas. Those measures should be much more progressive and much bigger than are now being undertaken, for the reasons I have already stated.

We don't need in the United States a share-the-wealth program. I don't believe in that. But we do need a distributive program. Our problem is distribution, and our problem is that two-fifths of all Americans live in poverty and deprivation, and we haven't opened up this great, mass market for our own productive capacity.

About the only good book on this subject comes to us from across the seas, a book that Mr. Murdall just got out on the Challenge to Affluence, in which he says that never before in history were the economic problem and the ethical problem so closely in confluence as in the United States today, and I really believe this. If our public leaders would set out as preachers and moralists and reformers to do what is right on the ground of ethics and morality in the United States, they'd get a wonderful solution to the economic problem and they'd also solve their political problem because, if they set out to do that and explained why they were doing it, they'd have the American people with them. It's just because they are not doing that that they are running into a political problem, because nobody knows exactly what they're trying to do.

Now, getting back to your question, which I forgot in the course of my discourse, let me review that question, unless my discourse has made you forget it also.

STUDENT: What counters or solutions do you propose?

MR. KEYSERLING: I'm saying that, if you had a redistribution program and opened up your mass markets to the two-fifths of our people who live in poverty and deprivation, you would have a much higher level of demand even from these conventional products. You'd have a higher demand for automobiles and for all these other things and, therefore, this would have a salutary employment effect upon these industries where the technological advance is so rapid.

In other words, if we brought a really nutritious diet to all American families--and there are millions without it--we would greatly increase the demand for farm products, and this would have a partially ameliorative effect upon the rate of productivity growth in agriculture, which is stupendous, similar to our mass-production industries. This is Point 1.

So that these programs which increase aggregate demand--if they did this through the right methods and didn't just increase it at the top, which is the wrong method because it simply leads to saving which can't be used--would help even in these industries.

What I said was that, after you get all through with that, the rate of technological change in agriculture is so high that, even if every American had a nutritious diet, you can't maintain as many people on the farms 10 years from now as are there now. In other words, you have to project the trend. Whereby a number of years ago it took 50 percent of our population to supply us with food, and more earlier, it now takes only 8 or 9 percent.

The same thing is happening in manufacturing. Therefore you have to find new industries, let us say, comparable to the automobile industry with all its ramifying effects in the 1920's. Now, what are these new industries? These new industries must serve our still great unmet national needs, and what are they? They're the rebuilding of our cities; the improvement of our housing; the reconstruction of our urban environments; the bringing of our hospital and health services up to the levels of our medical technology, for all the people and not just for one-third of them; the enlargement of educational opportunity, which means both plant and people; the purification of our water, which would be the clearance of our atmosphere of pollution. All these are things that over the next 10 years could provide the answer--or a substantial part of the answer--not to the additional employment which will occur in your conventional industry from an adequate rate of economic growth but to the 10-million problem, which the President certified when he said that, even assuming a good rate of growth, 10 million people are going to be dispossessed from these mass-production industries.

I ask, if the Labor Department itself is saying that 10 million people are going to be dispossessed from these mass-production industries, how you are going to take care of them? They say we will take care of them by enabling people to spend a little more for the products of these mass-production industries, because the estimate of the dispossession of the 10 million assumes a fully active economy. In other words, they are all mixed up, to state it simply.

These 10 million, as distinguished from the 12 million, can be taken care of only by new areas of economic activity which I have identified. These new areas require an entirely different product-mix as between public and private outlays and they require an entirely different credit-and-interest-rate policy for private investment from what we have now.

This isn't even being looked at, as we concentrate our attention almost exclusively upon the tax bill which would cover only a very small part of the problem, even if it were adequate in size and proper in quality, and which would cover an even smaller part of the problem when it is inadequate in size and rather poorly devised in quality.

QUESTION: Do you recommend a change in the length of the work week to improve employment and national growth?

MR. KEYSERLING: Yes and no. If we had a nationwide, effective, full-employment policy we should much prefer this to shortening the work week, because a 40-hour work week is not intrinsically too long from the viewpoint of health and adequate leisure, as the 70-hour work week in the steel mills was too long a couple generations ago. Second, we can well use the additional product that the 40-hour work week would yield under full employment, because we have so many tremendous, unmet national needs, not to speak of the world situation. Third, even the working people, who have some right to define for themselves how they want to live, despite the view among so many others that only others should decide it for them, I think, would prefer to be employed rather than to have more leisure provided that they were employed.

So every argument is against the shorter work week except one argument. The one argument is that those responsible for representing the interests and improving the well-being of working people in large numbers cannot listen to the theoretical arguments of the Government and the leadership which aren't doing the other things and which are showing no capacity to reduce unemployment, and under those circumstances it is perfectly appropriate and right that those directly responsible for the well-being of these people under a democratic system should prefer to share the unemployment, if they have to endure it, and the shorter work week helps them to share it. So you can't blame them for being for a shorter work week. The shorter work week is the byproduct of a partial bankruptcy in national policy. If this bankruptcy continues, the pressure for the shorter work week will become more extreme.

You always get unfortunate solutions, whether you are dealing with the racial problem or whether you are dealing with the economic problem, if you create a vacuum by not providing in time the proper solutions.

QUESTION: Sir, if we adopt the national economic budgeting process, would we tend to accentuate business cycles and diminish these national ups and downs?

MR. KEYSERLING: I think we would greatly diminish the ups and downs, because I think the state of economic knowledge is adequate to this task. As a matter of fact, when we criticize things as they are today, we've got to remember that they are better than they once were. Whatever reasons may be given, the fact is that since World War II, which is now a long way off--28 or 29 years--we've had only moderate ups and downs in the economy, costly, to be sure, whereas before World War II and before the great depression, we had a rather serious economic downturn every 7 years or so, so that there has been a great deal of progress in producing a stabilized forward movement of the economy.

What I am talking about is not that we haven't done better than we did a generation or two ago but that we are not doing nearly as well as we can now, and that this creates great problems. It's perfectly clear to me, although others will argue the point, that the policies that I am talking about would further stabilize the American economy and would further enhance its long-range rate of growth. Besides, they'd be self-correcting. If they didn't work you could modify them from year to year.