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Remarks of
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$1065 BILLION AS GOAL AND FORECAST

A little over three weeks ago the Budget Message and the Economic Report came out with projections that the gross national product in 1971 would be $1065 billion. The figure was an instant sensation. It immediately became, as far as I can recall, the best known GNP number in history. The only rival would be the $100 billion figure that Franklin Roosevelt once used as the goal for the recovery of the economy in the late 1930's.

The immediate reaction to the $1065 billion was not applause and approval. Rather it was shock, skepticism and suspicion. What was sensational about the figure was that it was, or seemed to be, far from the standard forecast of most economists not only in its magnitude but also in its meaning and method of derivation.

I think the number is important both for this year's economic outlook and for the making of economic policy in the future. Therefore, I think the best service I can perform today is to discuss this figure.

Let me say at the outset that the shock at the $1065 billion figure was in some measure due to cultural lag. This was the first official GNP forecast in excess of one trillion dollars. People are not used to how large all the figures have become. It is only a little over 10 years since the GNP passed $500 billion and a little over four since it passed $750 billion. A total of $1065 billion, an increase of $88 billion from the previous year and a discrepancy of $15 or $20 billion between our forecast and the conventional forecast all seemed enormous numbers. But in fact, they are not enormous numbers. The forecast increase in GNP is 9% from 1970 to 1971, compared with an average annual increase of 6.4% in the 20 years from 1950 to 1970. The increase in real output is about 4.5%, compared with 3.6% average annual increase in the past two decades. The difference between our forecast and the standard forecast is 1-1/2 to 2% of the GNP, which is not much beyond the average error of the standard forecast in the past.

Still, I do not want to minimize what we are saying or its difference from the consensus forecast. Without regard to the specific GNP numbers, we are aiming at and forecasting a path for the economy that will significantly reduce the rate of unemployment during 1971. The consensus forecast is of a languorous revival that would leave unemployment at the end of the year around the 6% with which the year opens. That indicates the real issue. Should we, can we, will we reduce the unemployment rate during 1971, and how? The Administration is saying that we should, can and will -- by expansive fiscal and monetary policy supplemented with moderate direct restraints on particular prices and wages.

We are saying four things about the $1065 billion.

1. We believe a path of the economy which amounts to a GNP of $1065 billion in 1971 is a desirable path.

2. Achievement of the $1065 billion GNP in 1971 is the Administration's goal.

3. We believe that achievement of the $1065 billion GNP is feasible.

4. We believe that the goal will in fact be achieved.

I would like to discuss each of these points in turn.

<u>Is $1065 billion a desirable outcome?</u>

I have already indicated half of the reason for considering a $1065 billion GNP in 1971 as a desirable outcome, certainly more desirable than the more commonly forecast outcome of $1050 billion. That half of the reason is the effect on unemployment -- the achievement of a significant reduction of the unemployment rate rather than continuation of the present rate. However, this invites the question, why not $1070 billion or $1075 billion? Wouldn't they reduce unemployment even more? The answer, of course, lies in the inflation problem. We believe that $1065 billion is better than, say, $1055 billion or $1075 billion, because it is more likely to be compatible with both a reduction of the inflation rate and a reduction of the unemployment rate.

If we get a moderate reduction of the inflation rate during 1971, say to 3-1/2% by the end of the year, the $1065 billion GNP would mean an increase of real output sufficient to reduce unemployment to about 5% by the end of the year. Such a rate of increase of output and reduction of unemployment would, in turn, be consistent with and help to bring about the moderate reduction of the inflation rate. The pace of the increase of output and reduction of unemployment would not exceed what had been achieved in previous recoveries when the inflation rate continued to subside. We would have had two years of unemployment in the neighborhood of 5%, that is to say, two years of slack in labor markets. We would have had two years of pressure on employers to raise productivity and reduce costs. These circumstances would, in our opinion, lead to a continuation of the reduction of the inflation that has already begun. And the decline of unemployment that would go along would achieve a great deal, even if not everything that would be desirable, on the unemployment front. It would puncture the general feeling of insecurity that results from a prolonged high rate of unemployment, it would stop the rise in the number of long-term unemployed and it would, of course, make progress towards a much lower overall rate.

Achievement of a larger GNP than $1065 billion might get the unemployment rate down faster. But if the GNP were significantly larger -- and it is no use talking about one or two billion dollars anymore -- we think the inflation risk would be greatly increased -- to the point where the inflation rate might be rising rather than falling. On the other hand, rates of economic expansion significantly below the $1065 billion GNP path would probably worsen the unemployment performance substantially without much gain on the inflation front. We are in a situation where much of the ongoing inflation results from the continuing momentum of past developments and will respond more to the passage of time than to current economic conditions, so that we can have a more vigorous economy, up to a point, without reviving inflation.

Of course, we are in a somewhat new part of the economic map, and no one can honestly claim to be sure of the relations among output, unemployment and prices that will exist in the next year or two. Obviously there is some rate of expansion that is too high and some rate that is too low. Recognizing the fallibility of such judgments we have concluded that the $1065 billion path would be desirable. Our feet are not frozen in concrete and obviously policy will have to be adapted to the lessons of experience as they emerge. But we should not allow our anxiety to be the father to our thought, and we should not exploit the popular anxiety by crying that the sky is falling just because policy reaches for an orderly expansion.

In order to help assure that the inflation rate moves down as the real economy moves up, the Administration has become increasingly active in using its influence to restrain directly price and wage increases in particular industries. Our current wrestling with the construction cost problem is the latest in a series of steps running from lumber, to copper, to oil, to steel, and including the Inflation Alerts, the Purchasing and Regulation Review Board, the National Commission on Productivity and the internal reviews by the Cabinet Committee on Economic Policy. Without any grand announcement, we have now taken on a large number of the ingredients of what is loosely called incomes policy. Nevertheless, resolutions continue and will continue to be solemnly passed urging us to adopt an incomes policy.

$1065 billion as target

We are saying more than that $1065 billion GNP in 1971 is a desirable outcome. We are saying that the Administration takes this as a target and recommends it as a target for the rest of the Government. This itself is an important fact and will influence the outcome, regardless of whether or not the Administration is right about its being a desirable outcome.

The Employment Act of 1946 requires the President to describe the path of the economy that will best meet the objectives of the Act, namely "maximum employment, production and purchasing power." The figure of $1065 billion GNP for 1971 may be taken as a short summary of the Administration's view of the economic performance that would move towards those objectives most satisfactorily. The Act also calls for the use of all of the resources of the Government, and not just of the Administration, to achieve those objectives. The Administration understands that to call for the use of the resources within its control to achieve the $1065 billion path -- again regarding

$1065 billion as a shorthand description for a vigorous expansion path significantly reducing unemployment during 1971.

Is $1065 billion feasible?

It is sometimes said that $1065 billion is a fine target but is too optimistic. I must say that I do not look at the proposition in this way. I would not regard the target as a good one if there were not a reasonable prospect of achieving it, because I do not believe it is the proper business of Government to generate expectations which will not be realized.

More important, I don't think our attitude towards the $1065 billion can be located on the scale from optimism to pessimism. If we were saying that the $1065 billion would come about spontaneously or be produced by forces beyond the reach of Government policy, that might be judged optimistic. But in fact, although that might conceivably happen, we are not expecting and do not count upon spontaneous generation of $1065 billion. What we do count upon is the feasibility of the goal if there is determination to use the available policy instruments.

We believe, as we have said many times, that the $1065 billion goal can be achieved by the President's budget and a complementary monetary policy. The President's budget is clear enough. It will run a deficit of $18.6 billion this year and $11.6 billion in the next fiscal year. If the economy were operating at full employment in both years the budget would be balanced in both years. As we see it, this budget policy will support the expansion of the economy at the desired rate but is not sufficient by itself to produce the desired expansion. We depend heavily on the other part of the formula, namely "complementary monetary policy."

The Administration has not undertaken to specify what a complementary monetary policy is in the sense of specifying a rate of growth of money, or credit, or any other quantity. It is the business of the Federal Reserve to determine such things. Our goal is a certain growth of GNP, not a certain growth of money. However, what is clearly implied in the Administration's statements is that there is a complementary monetary policy. There is a monetary policy which when added to the fiscal policy will reach the goal.

To avoid being distracted by irrelevancies we should make certain qualifications at once.

First, we do not believe that the GNP is determined by money alone.

Second, we do not believe that there is a one-for-one relationship, such that a dollar of money yields a dollar of GNP or a one percent increase in money yields a one percent increase in GNP.

Third, we do not believe that the relation between money and GNP is invariant -- the same in 1971 as in 1951.

Fourth, we do not believe that the relation between money and GNP is precisely known.

Fifth, we do not believe that the effect of money on the GNP is instantaneous.

All of these things would have to be said, and would be significant, if we were talking about reaching a GNP of $1045 billion or $1025 billion, just as much as when we are talking about a GNP of $1065 billion. They are the "what goes without saying" of monetary policy, or of fiscal policy too for that matter. They mean that error in the achievement of any total GNP target is inevitable, but not necessarily greater in achieving $1065 billion than in achieving a smaller number.

These qualifications do not deny the central propositions that the GNP will be larger in 1971 the larger is the money stock, that this will be true for GNP's of $1065 billion or higher, and that the $1065 billion GNP will be the most probable outcome if policy aims for it.

The critical point, as I see it, is that within the range of interest to us monetary expansion does not lose its potency and reach a point where it fails to generate more GNP expansion.

The argument now being revived about the limits to expansive policy naturally thrived during the 1930's and it is worth recalling that episode and its sequel. There were, in fact, two different approaches to the problem then.

One was an attempt to explain why an increase in the stock of money would not produce an economic recovery. This was one of the central points of Keynesian economics of the late 1930's. Although the Administration has recently been declared on high authority to be Keynesian, this is not an aspect of the Keynesian doctrine that the Administration has accepted. Keynes invented for this purpose the notion of the liquidity trap, namely a situation in which interest rates had fallen so low, absolutely or relative to expected future interest rates, that increases in the money stock were simply absorbed into hoards without any effect on interest rates or on the real world. Keynes was somewhat ambiguous about whether this situation actually existed in the 1930's or was still to be encountered in the future. His disciples as usual were less cautious; they found the liquidity trap right in front of them. Nevertheless, whatever may or may not have been true in the 1930's nobody has claimed to find the liquidity trap since the war ended and there is no evidence that it has appeared or reappeared today.

The second argument was an argument against the effectiveness of both fiscal and monetary policy for expansion. Unlike the Keynesian argument this was essentially a conservative or businessman's argument and it hinged on confidence. The economy was said to be depressed because business lacked confidence. Expansive policies would do no good but would actually make the situation worse because they would weaken confidence. During the first two terms of F. D. Roosevelt the list of things that caused lack of confidence was lengthened to include the Wagner Act, the SEC, Social Security, the TVA, the undistributed profits tax and many similar items. Surely there was plenty of reason for lack of confidence during the Depression. But still, when vigorously expansive measures were taken all the signs of confidence reappeared, and the New Deal policies that had been destroying confidence permanently lost their sting.

Lack of confidence has now come back to the center of the stage as an explanation of the claimed limit on the ability of monetary policy to generate the target GNP. If lack of confidence simply means that households and businesses are spending less relative to their incomes and money holdings than they might this is certainly true. However, the evidence that they are spending less than "normal" is not unequivocal and would depend on some speculative calculations of what is normal. Moreover, the use of the word confidence does little if anything to explain this phenomenon or suggest a solution.

However, the main question is not whether lack of confidence is an element in our present situation but whether it is the only element, so that other measures cannot offset it or correct it. Specifically, have we reached such a state of confidence that increases in the money stock do not cause the purchase of other assets, including stocks and bonds, increasing the value of wealth owned by households, reducing the costs of borrowing, stimulating expenditures for housing and State and local facilities, and in turn and in time also stimulating expenditures for consumers' durable goods and business investment? There is no evidence that we are in such a condition and much evidence to the contrary.

It is not belittling the importance of confidence to say that other forces, including monetary policy, also have an effect on the economy and can affect and change confidence. The Administration believes that confidence in the American economy is justified. It intends to act in a way that will demonstrate the justification of confidence, and most of all by promoting an orderly, vigorous expansion. We believe that the current state of confidence strengthens rather than weakens the force of expansive fiscal and monetary actions, because those actions will yield a favorable effect on confidence.

Will we do it?

We believe that $1065 billion GNP in 1971 is a desirable path for the economy, we take it as the Administration's target and we believe it to be feasible. Even if we are correct in these beliefs, the question whether the $1065 billion figure is probable remains. The question would boil down to this: Out of the division of labor among the Administration, the Federal Reserve and the Congress can a policy be fashioned that will add up to the result the Administration has described as desirable?

Of course, no one can offer guarantees about this. Still our confidence that the $1065 billion will be attained depends on the answer being affirmative. All of the parties share the same general objectives, they face the same facts, they are in communication with each other and they are reasonable people. We expect them to reach their common objectives.

It is not in the nature of the Federal Reserve to specify its targets publicly far in advance, either for the gross national product or for the monetary variable. Certainly it is not my role to predict their policy. Yet certain very recent evidence may be cited.

Speaking last Friday before the Joint Economic Committee, the Chairman of the Federal Reserve said that the System "will not stand idly by and let the American economy stagnate for want of money and credit" and "will not become the architects of a new wave of inflation." These objectives, of course, the Administration shares. Moreover, Chairman Burns said that the $1065 billion GNP figure for 1971 was admirable as a target.

More specifically, the Chairman said that "while a high rate of growth of the narrowly defined money supply may well be appropriate for brief periods, rates of increase above the 5 to 6% range -- if continued for a long period of time -- have typically intensified inflationary pressures." He also pointed out that in the first year of periods of recovery the income velocity of money has risen in the past by amounts ranging from 5-1/2% to nearly 7%, and that if velocity did not rise in 1971 in line with past cyclical patterns, then relatively larger supplies of money and credit may be needed. If we put together the increase in the money supply and the increase in velocity implied by these statements, there is room for at least as rapid an increase in the GNP as the Administration has contemplated.

I do not cite these statements to deduce from them anything more than they plainly say. But I do want to suggest that the reporting of all such matters in the press tends to give the picture of an intractable disagreement that does not really exist.

The problem with the Congress is different, not so much because there is more disagreement, although that may be true, as because Congress is not organized to make any unified decisions about policy from the standpoint of the national economy. There is danger that in the pushing and pulling over particular expenditure programs we may come out with a total that is far away, in either direction, from our economic requirements. This would now seem to be a danger more for 1972 than for 1971, because the open questions mainly relate to next year. The problem is going to require constant attention but is probably not going to be decisive in its short-run effect.

I want to close by reemphasizing that we do not regard the goal -- summarized by the $1065 billion figure -- as being assured simply because we have declared it to be our goal. We read the papers, do the arithmetic and think we know how hard it will be to achieve. But we think it is important to achieve, feasible, and probable with determination.