The Outlook for the Economy[1]

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The late Adlai Stevenson once defined an editor as a man who separates the wheat from the chaff—and prints the chaff. There is considerable truth in that barb. The evidence is available every day in the newspapers, which lavish column after column upon the minutiate of the latest economic moves—and misleading statistics—from Washington. I will try to deal today with the fundamentals of the situation that confronts the American economy. The situation is far more troubling than most published accounts would lead one to believe, at least if you value economic freedom and its historic handmaiden, political freedom. We have surrendered, perhaps forever, a vital part of our economic freedom. We have done so not with sadness, but with a good deal of cheering from the sidelines. The spectacle has been a crowd pleaser. I recall that much the same sort of mindless applause accompanied the demise of the Italian Parliament in Benito Mussolini's day and the German Reichstag's suicidal grant of extraordinary powers to a controversial chancellor named Adolf Hitler. Of course Richard Nixon is neither a Hitler nor a Mussolini; historic parallels are seldom comfortably exact. But the drift is the same: the U.S. in mid-August took a perilous step toward fascism—the corporate state. Only now, after about six weeks of reflection, are a number of businessmen beginning to voice doubts about whether the straitjacket that they have been applauding will be permanent and onerous. I suspect that it will be both, and I will get to the reasons a bit later.

Now that I have confessed a Cassandra-like bias about the long term outlook for the American economy, let me confuse you some more by admitting that I am quite optimistic about the prospects for 1972. I am optimistic, at least about the kinds of numbers that go into ordinary economic forecasts. Speaking for myself only, it seems quite possible that the U.S. economy next year will experience its fastest real growth since the mid Sixties. Real growth—that is, the increase in our total output of goods and services, minus the effects of inflation—will probably amount to a disappointing 3% in 1971, because the purchasing power of our money is still dwindling at the worrisome rate of 4.7% for the year. But for next year, the prospect is that real growth may increase to about 6.25%, while the inflation rate dwindles to 3%. With that, the economy may increase in size by a spectacular $100 billion, or almost 10% in current dollars.

Those figures are the majority forecast of the board of economists of *Time* Magazine, FORTUNE's sister publication. There are three crucial conditions: (1) a stimulative tax program (which Congress seems sure to vote); (2) reasonable success against wage and price increases in Phase Two; (3) little retaliation from abroad because of the Administration's 10% import surcharge. As prognosticators, that board has proved itself to be amazingly accurate. A year ago, for example, its members correctly predicted that the recovery from the mini-recession would be slow and that unemployment would remain unpalatably high. I recall all this quite vividly because, among other reasons, I spent the past seven years, until last May, writing for and sometimes editing *Time's* Business Section. This meant that I sat in on all of the board's deliberations and joined in the questioning. When Walter Heller, Otto Eckstein, David Grove and Beryl Sprinkel agree about an economic outlook, you have a convergence of opinion from virtually the whole economic spectrum. A final filip of encouragement: the *Time* board expects that unemployment will drop from the current 6.1% to about 5% by the end of next year.

So much for short run optimism. For the rest of the time this afternoon, I propose to talk about the fundamentally disorderly condition of the U.S. economy, Nixon's New Economic Plan, and the chance, if any, that the nation can work its way out of today's straitjacket of controls. This comes in five parts: (1) how did we get into this mess? (2) what will the freeze accomplish? (3) will there be a trade war? (4) what are the possibilities for Phase Two? and (5) has the U.S. "enterprise system" had it?

First, *how did we get into the mess?* As you recall, when Congress voted him power to freeze prices and wages, President Nixon said he didn't want it. Again and again, he and the chief economic spokesmen of his Administration have belabored the idea as abhorrent to American principles. Let me quote a bit from the wisdom of Paul McCracken, the chairman of the Council of Economic Advisers: "General price and wage control would be a serious threat to economic freedom. . . . The common image of price-wage control is entirely wrong. The image is that a little band of dedicated, objective, analytical men in Washington would keep a few heads of powerful corporations and unions from exploiting us. The fact is that it is *us* who would be and would have to be controlled. And the control would have to be managed . . . by the same kind of people who run all the other agencies in Washington; that is, they would be political and bureaucratic." Finally, McCracken went on to say: "Wage-price controls threaten to speed up inflation . . . from the demand side." Unquote.

Why, then, did the Administration adopt the very course that it had sworn to avoid? Well, it seems to me that the important insight here is that Richard Nixon is first of all a political animal. He tries to find out what people want. What happened was that the political demand for controls became overpowering. It ultimately forced him to overrule his better economic judgment. After all, the first law of politics is survival in office. The old "game plan"—the one with which the Nixon Administration tried to end inflation by slowing down the economy ever so gently—was working, after a fashion, but not quickly enough to satisfy the ever impatient American people.

We should not forget that the Nixon Administration inherited the inflation that lies at the root of U.S. economic problems. That inflation began in 1965 and 1966 when Lyndon Johnson refused to go along with the suggestion that we raise taxes to pay for the soaring cost of the Vietnam war. Even worse, he bamboozled Congress and a lot of other people who also should have known better into thinking that we could afford *both* guns and butter. The cost of the Great Society was superimposed on the cost of our Asian misadventures without the presentation of the bill, in the form of higher taxes. By the time that Johnson reversed himself, and Congress very tardily raised taxes, it was too late. Inflation was dug into the economic fabric of the country. As Economist George Cline Smith likes to say: "Inflation is like heroin addiction. Once you have it, you can't cure it without withdrawal symptoms."

The pressures of inflation produced nasty economic consequences. German and Japanese automakers began to carve out a larger and larger segment of the U.S. auto market. Foreign shoes, textiles and typewriters flooded our stores. Our trade balance, once the mightly mainstay of the international strength of the dollar, tumbled into deficit. Our balance of payments did the same. Our once towering store of gold dwindled and dwindled as foreign nations called upon the U.S. to make good its pledge to redeem dollars held by foreign central banks for the yellow metal, at $35/oz. Today the world's central banks

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hold $28 billion worth of U.S. money, and the U.S. gold reserve has shriveled to amere $10.5 billion. The foreign bankers were growing restive at that imbalance. It wasn't considered patriotic form to speculate about it in print, but it has been clear for some time that the U.S. would eventually have to take the action that President Nixon took in mid-August. Along with wage-price controls, he slammed the "gold window"—that is, he refused to pay U.S. gold for any more foreign held dollars—thus repudiating the solemn pledge of the U.S. upon which the whole international monetary system had been laboriously constructed.

What will the freeze accomplish? Mainly, of course, it buys time. Time for the Administration to concoct a program to succeed it when the ninety days of wage-price control expire November 13. The freeze is not a panacea. At best, it is nothing more than a short run supplement *to, not a long run substitute for a non-inflationary* monetary and fiscal policy. In ordinary language, this means that: (1) the Federal Reserve must behave itself and refrain from expanding the money supply faster than real growth in the economy warrants; and (2) Congress and the Administration must not spend more money than they tax us. As Citybank said in last month's Economic Letter, "monetary policy is the vital silent partner in the August economic package." Unfortunately, on the track record of recent years, the Reserve Board inspires little confidence for its monetary management. The board is notoriously oversensitive to conditions in the money market—that is, the short term gyrations of interest rates, the condition of bank reserves, the demand for various kinds of bonds and credit. As for fiscal prudence, we are heading for a $28 billion federal deficit already. And after Congress gets through sweetening the President's proposed tax cuts, it wouldn't be surprising to see the red ink increase.

The wage-price freeze was also intended to give business and consumers a psychological lift. In this sense, to be fair, the maneuver seems to have succeeded. FORTUNE polled some 250 businessmen recently and two out of three said that their business prospects had improved because of Nixon's actions. Business confidence has rebounded to the highest level in two years. Consumers are rushing out to buy new autos, and perhaps that mood will spread to other retail spending.

The big question, of course, is what next? What are the possibilities for Phase Two? Pretty clearly, the Administration is going to concentrate its enforcement on the easy and visible targets: Big Business and Big Labor. It may work, but I wouldn't count on it. George Meany has threatened noncompliance with post freeze policy, and certainly any wide rebellion by organized labor would make controls by consensus a dubious proposition. The alternatives are much worse, to be sure. A program without the teeth that Nixon has promised would only invite violation. A harsh program would require the kind of patriotic public support that this country has shown only during wars that were widely regarded as necessary.

Will there be a trade war? Well, maybe yes, maybe no. It depends on whether political leaders and finance ministers of the world's major industrial powers can agree quickly enough on how to devise another international monetary system to replace the one that Nixon shattered. I do not blame the President for his action; it was not only overdue but provoked by foreign obstinacy. The same goes for his 10% surcharge on imports, which is giving Europe and Japan fits. As Secretary of the Treasury Connally says, the U.S. "like Atlas, has been holding up the world for 25 years." Remarks like that always infuriate the leaders of countries that we endowed with generous aid after World War II. But two things have happened: (1) despite tariff cuts, many of the U.S.'s trading partners impose a subtle but effective web of nontariff barriers expressly designed to keep U.S. products out of their domestic markets; (2) as the value of the dollar has declined, owing to inflation, other countries have generally avoided raising the exchange rate of their own currencies vis-á-vis the dollar to reflect the new reality. The old monetary system, which grew out of the conferences at the New Hampshire resort town of Bretton Woods in 1944, is in ruin beyond repair. The foundation is gone—that is, the U.S. promise to redeem dollars with gold, at $35 per ounce. All other currencies, under IMF rules, are defined by their relation to the value of the dollar. So the U.S. has no legal way to devalue the dollar vis-á-vis just a few strong foreign currencies—Japanese yen, German marks or Swiss francs. It can only devalue the dollar as measured against the strong and the weak monies of the world alike, by raising the price of gold. Other countries can write up the value of their money as against the dollar, but "revaluations" are politically unpopular and frequently slow down the economy of the country that carried them out.

Given the economic and financial pressures for revaluation, and their reluctance to take such a step, Germany, Japan, The Netherlands, Britain and other countries have been forced to float—that is, to let free trading in the world's money markets set the international value of their currencies. (This is also forbidden by the IMF rules.) So far this free trading has pushed the value of the D.M. up by about 10%, that of the Japanese yen by 7.5%, the guilder by 7%, the British pound by 3.5%. To be sure, some countries are trying to rig this game. The Japanese, in particular, have been conducting what economists call a "dirty float"; they are intervening in the money markets' pricing by buying or selling their own currency, buying dollars with their own currencies if the value rises too far above a desired limit.

One big trouble with floating currency values is that they inhibit world trade. They make it difficult, if not impossible, for businessmen to predict their profits: they can't tell what the coin that they will be paid in will be worth by the time they get paid. Yet world prosperity depends largely on the free circulation of money, goods and travelers across national borders. The U.S. import surcharge, intended to end our chronic balance of payments deficit, tempts foreign governments to retaliate against U.S. goods and investments. If this happens the free world could easily wind up in another major depression, which is what happened in the Thirties. Let us never forget that the Depression was both lengthened and deepened by rising tariff barriers and economically suicidal competitive devaluations.

Last week's IMF meeting in Washington raises considerable hope of averting the worst of all possible monetary crises. Compromise seems to be in the wind. Secretary Connally offered to scrap the hated surcharge in return for "tangible progress" toward lower trade barriers abroad and cleanly floated currency rates. There is hope, but the world is not yet safe from the hazard of calamity. It will be safe only when the international monetary system, which now lies shattered like Humpty Dumpty at the bottom of the wall, is somehow put back together again.

Has the "enterprise system" had it? Well, the signs are ominous. For about 40 years, ever since the New Deal, the trend in the U.S. has been toward more government encroachment over all aspects of the economy and society. With only brief pauses we have had increasing taxes, subsidies and controls. Bit by bit economic decision making has shifted from the marketplace to Washington. The recent federal rescue of Lockheed Aircraft, which was also a bailout for numerous imprudent banks, moved us a long way down the route toward the corporate state, which is the label that was used to define Mussolini's brand of economic dictatorship in Italy. Mussolini made the Italian trains run on time, and it is no comfort at all to report that our new quasi-government corporation, Amtrak, is managing just about the same thing.

The most chilling aspect of our leap into wage-price control, however, is that so few have attacked the principle of it. Business spokesmen overnight buried their rhetoric about free enterprise and the market price system. Unions, and many of Nixon's political opponents, have been complaining mainly that the freeze isn't fair because profits and interest rates weren't frozen as well, and because the President has proposed that business receive "undue" tax breaks. At best this is sloppy criticism, at worst blatant demagoguery. The trouble with profits is not their altitude but their depth. Last year's corporate profits, adjusted for inflation, were 30% below their 1966 peak and a bit below their 1963 level. On the same basis, employee pay per hour worked, was up 8% from 1966 and up nearly 18% from '63. Interest rates seem to be heading down, at least temporarily; any freeze would serve to prevent a welcome reduction. As for the investment tax credit, it would surely lead to bigger orders for equipment and more orders for materials to make it. The result: more jobs and more efficient factories. Still, though I regard many of George Meany's ideas as a menance to the republic, I am happy to find him quoted in the papers this week to this effect: "If we go down the road of controls, it will begin to look like fascism." He is, I submit, quite right about that.

We face hard choices, much harder than our political leaders or our press is telling us. If our enterprise system is to survive over the long pull, I believe that we must begin now to think about much more fundamental reforms than either Congress or the Administration so far shows any inclination even to *discuss*. If labor is to be persuaded to give up its piratical appetite for outrageous and inflationary wage increases, some other accommodation will be necessary. One splendid but generally overlooked possibility is genuine profit sharing by business and industry, not the tax-dodge variety that prevails today. Another, so complex that I will only sketch it here, is the ingenious proposal of a San Francisco lawyer named Louis Kelso to give workers what he calls "a guaranteed second income," so they needn't worry so much about the level of their wages. His plan, which the Nixon Administration is studying seriously, would let about 80 million workers buy blue chip stocks with borrowed money, and so ultimately enjoy a substantial return from dividends.

A few companies have already used Kelso's basic idea to set up tax-sheltered trusts that enable their employees to become stockholders on credit. For instance employees used much a fund to buy Peninsula Newspapers Inc., which published dailies in three suburban San Francisco cities. Last week when I had lunch with Kelso, he told me that after a decade many of the printers and pressmen at the company have amassed retirement nest eggs of $80,000–$100,000. Kelso's amazing scheme actually works!

We need radical tax reform of several kinds. (Labor must be stripped of its coercive power, which is the antithesis of rule by law, to compel outrageous settlements. But labor must be offered a better alternative than today's economy wrecking course.) We need a much more sophisticated and finely honed system of land use control than today's clumsy zoning ordinances. Most of all we need to zero in on some fundamental problems about the American enterprise system. Today about 5% of the population owns the capital—money, securities, land and tools—that actually produces about 90% of the wealth. It is an undue concentration of capital. And it means that the rich grow richer while ordinary working men and women, you and me included, have little chance to obtain a worthwhile share of the nation's abundance. As our economy operates now, we ameliorate this problem in Alice in Wonderland fashion; by heavy government outlays for welfare, by a tax system that aims to redistribute wealth, and worst of all by makework activity. Perhaps a third of the U.S. work force is occupied on dubious construction or military projects, or sustained by subsidies that prop up inefficient enterprises.

We have forgotten the lessons of history. Until the close of the western frontier, even the poorest American laborer could acquire "capital" almost free, in the form of homesteaded land. Now that the free land is about gone, we seem to have lost sight of a centuries-old truth: property is the only power that can protect an individual's political freedom and rights. To state it another way, economic freedom and political freedom are indivisible. A century ago, these principles helped to forge a nation to which the suffering peoples of other countries flocked in the hope of a better life. Let us pray that the sins of satiety—expediency, myopia and greed—do not make us lose sight of the political foundation of our economic achievement. Let us pray that we make the hard choices that will sustain freedom.

• *Abstracts . .*

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out using GLC as the analytical technique. Myristic and palmitic acids, methanol, octaeicosan-14, 15-dione and dotriacontan-16, 17-dione have been identified as by-products of the transesterification reaction. On the basis of the kinetic results, the mechanism of the reaction is discussed. It is hypothesized that a close relationship exists between the transesterification reaction mechanism and that of the acyloin condensation.

THE LIPIDS OF OIL PALM POLLEN. M.-T. Richert. *Oleagineux* 26, 261–2 (1971). The total lipids were extracted from a sample of pollen from *Elaeis guineensis* from Dahomey by ethanol followed by ethyl ether. The principal fatty acids were C 12:0, 3.8%; C 14:0, 1.6%; C 16:0, 28.1%; C 16:1, 1%; C 18:0, 4.5%; C 18:1, 5.2%; C 18:2, 32.2%; C 18:3, 15.5%; C 22:0, 1.3%; C 24:0, 3.6%. A sterol-rich fraction was separated from the unsaponifiables. It consisted of 23.5% sitosterol; 38.5% stigmasterol plus fucosterol plus isofucosterol; 21% campesterol; 10.5% methylene-24-cholesterol plus brassicasterol; and 6.5% cholesterol, as determined by mass spectrometry and TLC of the propionates on aluminum oxide/silver nitrate plates.

PACKAGING AS A MEANS OF PROTECTING LARD FROM LIGHT. P. Kalac *et al. Prumysl Potravin* 22 (4), 109–14 (1971). Different films were studied. Cellophane exhibited a certain amount of protective action, especially if red- or yellow-colored. The best results were obtained with aluminum foil. White parchment paper and white paper combined with polyethylene are not recommended. (Rev. Franc. Corps Gras)

INCREASE IN DISTILLATION RATE OF THE SOLVENT FROM OILSEED PRESSCAKE BY USE OF PSEUDOFLUIDIZATION. B. I. Muhamedov *et al. Izv. Vysshikh Uchebn. Zavedenii, Pishchevaya Tekhnol.* 1971 (2), 172–3. The authors studied under laboratory conditions the hydrodynamics of a pseudofluidized layer and the kinetics of solvent removal from cottonseed presscake. The solvent content of the presscake was lowered from 30% to 0. The distillation time decreased with increase in temperature of the effective surface. Pseudofluidization was found to increase the distillation rate by 15–20 times and 25–30 times compared to continuous and batch evaporators respectively. (Rev. Franc. Corps Gras)

FATTY ACID COMPOSITION OF HAZELNUTS. N. A. Thagusev *et al. Izv. Vysshikh Uchebn. Zavedenii, Pishchevaya Tekhnol.* 1971 (2), 39–41. Hazelnut oil resembles olive oil in composition. In the immature nuts, linoleic acid is the principal component while in the ripe nuts, oleic acid predominates. Irrigation of the plant retards formation of oleic acid, which results in a lower content of this acid at all stages of development. (Rev. Franc. Corps Gras)

THE RELATION BETWEEN THE DEGREE OF UNSATURATION AND THE