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Address of George P. Shultz
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PRESCRIPTION FOR ECONOMIC POLICY: "STEADY AS YOU GO"

I have a simple but apparently controversial thesis to present this evening: the basic strategy of economic policy and its current tactical implementation are generally on course and economic policy can benefit from application of the old nautical phrase, "Steady as you go."

For we are going -- forward with expansion of the economy, as the war in Vietnam continues to wind down, and as the pressures of inflation diminish in their intensity.

But also, with each passing day, the pressures mount to alter the course and to steer, not by the compass but by the wind, tossing caution to the wind in the process. I can assure you that these counsels meet strong resistance from the President.

Of course, there are problems. There are uncertainties to be monitored and adjusted for in the tactics of economic policy as new data become available. There are changes in the structure of demand and supply in the market place which must be taken into account. Unemployment is too high and there are pockets of unemployment created mainly by the shift from war to peacetime production that must be treated directly.

But beyond these issues, what are the broad objectives of the President's economic policy?

One strategic purpose of this Administration has been to slow a rapidly escalating inflation without inducing a downturn in economic activity.

Another has been to stop the Government budget from creating instability, which it had been doing, and get the budget onto a more sustainable basis, which is what we are doing now.

A third has been and is to create the conditions for steady economic expansion in a way that nourishes the freedom and innovative spirit of management, labor and individuals -- in a way that does not involve the takeover of the economy by Government.

Now, let's look at the results so far.

Inflation has begun a turn downward after a relatively mild slowing of the economy. It has taken longer than we hoped and unemployment has been higher than we wanted, but the progress is unmistakable. The Consumer's Price Index, for example, has declined in its rate of increase from over 6 percent in the first half of 1970 to a little under 5 percent in the second half of 1970 to about 2.7 percent in the first quarter of 1971. This is the lowest quarterly increase since the ~~second~~ first quarter of 1967.

A balance in the budget at full employment has been attained and held for all three Nixon years after three years of rapidly rising and ultimately tremendous deficits at full employment, thereby removing a destabilizing Government influence from the economy and replacing it with a steadying influence.

And now the economy is moving forward, having registered a solid advance of 6.5 percent in real GNP in the first quarter of this year, with the upward movement clearly and substantially stronger and more broadly based toward the end of the quarter than at the beginning.

Yet there are real differences in approach to economic policy today, and we would do well to recognize the disagreements and clarify the arguments.

There is a school of thought that our economy has changed to such an extent that the free market economy will no longer work well enough. In order to achieve stability, this school says, Government must do much more to manage the private sector. Some members of this school believe that more Government management is needed not only temporarily to cure our current inflation, but indefinitely.

It is time to challenge the basic premise that the economy has changed drastically over the past decade. "Times have changed" is a truism that is hard to refute -- but let us see what has changed and what has not.

A principal argument that has been used to justify this seeming newness is that corporations and labor now have a great deal more market power than they previously had.

In fact, however, there is little evidence that the power of business has grown, has become more concentrated or monopolistic in recent times. Studies of horizontal integration, which use concentration ratios and rates of return, find little evidence of a secular increase in this indicator of monopoly. Likewise, a study of vertical integration, which uses sales to value-added ratios, finds no evidence for a secular trend. Monopoly power does not appear to be on the rise.

When conglomeration was in vogue a few years ago, the spectre was raised of a dozen supercorporations dominating the business scene. But because conglomeration did not provide a magic formula for management or financial success, that threat has receded. Waves of conglomerate activity have been experienced in the U.S. economy before. As before, the aftermath of the recent wave has been its reversal. Anti-trust enforcement was a factor, but the free market itself provided the main self-cleansing force. The trend in business today is toward more competition, not less; and the successful conglomerates have often been the agents of this sharper competition.

Only in an atmosphere of false boom, of an economy superheated by government, covering up errors of business judgment, can inefficient aggregations of enterprise prosper. We have now seen what happens when government stops racing the economic engine beyond its capacity to perform: the wheeling and dealing gives way to a more fundamental, and more healthy, form of competition among business enterprises.

But what about organized labor? Has it grown in power so markedly in recent years that new regulations are needed in the labor market and in collective bargaining?

Let us look at the government sector of the economy. Here we see both rapid growth in union membership and rapid growth in employment, with the proportion rising from about 12.6 percent to about 18.2 percent of the government labor force over the years from 1956 to 1968. It is noteworthy but perhaps not surprising under the circumstances, that wage rates have risen especially rapidly in this sector of the economy. In my judgment, the problems of employer-employee relations in government will deserve and will command more and more attention in the years ahead. Certainly, we are far from a resolution of the fundamental problems involved and they are problems that will affect not only wages and costs -- taxes -- in the public sector but the private labor market as well. This is indeed a new factor in the picture.

In the private non-farm sector of the economy by sharp contrast, union membership grew only slightly, not nearly so fast as employment, so that its proportionate importance declined from about 38 percent to about 32 percent of this labor force. Lack of growth does not mean a lack of issues about present arrangements in the labor market; but, it seems fair to say, the issues are not newly created. It cannot be argued that the current inflation is associated with rising union strength.

Broad statistics on the increase in average hourly earnings of private non-farm workers show a level of increase that must be reduced if we are to have an extended period of price stability. At the same time, they tend to confirm the picture of no basic change in the arrangements of labor markets. The rise in wages and benefits over 12 month spans has moved largely within a narrow band between 6 and 8 percent for about five years. There are differential movements by industry, with non-union areas such as "trade" moving up more sharply when labor markets were at their tightest and reacting more quickly to the current slack. It may be noted that conditions in labor markets did not ease greatly until mid-1970. Conversely, fixed term contracts tend to produce a slower response in union rates when the labor market tightens but to project that response, unfortunately sometimes at an unwarranted and unwise level, on into a period of changed economic circumstances. This is, however, a well known phenomenon, identifiable throughout the post World War II period.

Another well known movement is also under way, one that has created great difficulty in the fight against inflation but which will now provide us some help. The top of a boom and a time of slowing economic activity are always times when the growth of output per man hour -- productivity -- also slows. But, as output rises again, productivity does so as well and initially at a rate above its long-term average. A little noted but very important aspect of the first quarter results was the appearance again of this predictable development: productivity rose at a rate better than 5 percent after three years of below average growth. This shift will make a dramatic difference in unit costs of labor and is a hopeful factor insofar as inflation is concerned.

But that is not the main point here. The point is that events are proceeding generally in accord with what might be expected on the basis of past experience.

There are special problems. High expectations for performance of the economy create a dynamic of their own. We have already noted the area of government employment . The construction industry has long been in difficulty and may well be helped out of at least some of its problems through efforts now being made, with stimulation from the President. And there are a number of other industries, notably transportation, where high wage settlements pose difficult cost problems.

The steel industry is very much on our minds. The problem here is not one of setting an inflationary wage pattern: steel is at the end of the round not the beginning. Nor is the industry so large and important that it can force a generally higher cost level on the economy. The problem is the reverse: the industry is weak, beset with competition from substitute materials, losing ground in world markets, and showing a rate of return that can hardly impress investors. These problems will be facing labor and management whatever the outcome of their wage bargaining and would be badly aggravated by a settlement that extends fixed, high increases into future years.

The answer to these problems is not more severe import quotas, for these will only put American steel users in a poorer and poorer competitive position at home as well as abroad.

Management and labor have a common and severe problem here. Working together with a common goal, they can make a big difference in cost per ton, even without major changes in technology. Perhaps government can help. Certainly a union that produced a Clint Golden and a Joe Scanlon can draw upon its traditions for constructive alternatives. We need leadership from the industry to produce a program that combines fair wages and competitive cost through high productivity. In this direction, there is a chance for secure jobs, important to young and older workers alike, and of adequate returns for the capital necessary to the long run health of the industry.

Two other problem areas deserve special note.

Economic activity in 1970 was substantially disrupted by strikes, which occurred with relatively high frequency. Strikes are unfortunate. Peaceful settlements are certainly to be preferred and we may expect 1971 to be somewhat more peaceful than its predecessor. But we must also remember that strikes occur most often when an economy is shifting its gears. Last year, when the brakes were applied to inflation, profit margins narrowed, making it difficult for companies to meet the rising demands of labor, demands often reflecting the absence of any gain in real earnings during the prior contract term. The result was conflict. But the fact of this conflict is not evidence that our system is breaking down. It is evidence that the system is working -- reacting, as it must, to the end of a spiraling rate of inflation.

Over the past two decades, we have engaged in more and more trade with the rest of the world. The high returns from this increase in trade have been shared by both Americans and foreigners.

In addition, competition from abroad has served to protect the consumer in the United States. The share of the economy represented by trade in goods and services has increased from about 9% to over 12% of GNP since 1950, with exports growing from about 5% to 6½% of the GNP and imports from a little over 4% to about 6%.

But this increased trade, especially the imports, has posed severe problems in many industries and imposed inequities in some cases. The whole area of international economic policy deserves careful, hard-nosed, and comprehensive review. That review is going forward now under the aegis of the new Council on International Economic Policy created last February by the President's Executive Order.

The President, who has travelled to 67 countries over the past 24 years, is determined that, when American business goes abroad, its interests will be strongly represented and advocated by our Government.

Perhaps the most troublesome problem from the standpoint of economic policy generally is the area to which I am the closest: the Federal Budget. The upward thrust built into this gigantic flow of spending is awesome, and there is a continuous and continuing threat that outlays will develop a momentum carrying them well beyond full employment revenues. Tempting though the immediate prospect of such free spending seems to be, it is bad news for the long-run prospects of the economy. Inflation or a tax increase follow in its wake.

For Fiscal Year 1971, despite a deficit we now estimate at about $19 billion, outlays will be held just within full employment revenues; but only because of the President's willingness to veto apparently popular spending bills and of the willingness of a sufficient number of Congressmen to stand with him.

Fiscal year 1972 will not start for another ten weeks, and Congress has barely started its work on this budget. Yet action so far, other things remaining as in the President's budget, already carry the deficit above $15 billion and outlays to a level well above full employment revenues.

We desperately need a steadiness, a sense of balance and longer-term perspective in our budget policy. The years 1971 and 1972 are certainly important to this Administration, but we must operate also with an eye to 1973 and beyond.

Do we have the ability -- perhaps a better word is "guts" -- to hold a steady course on the budget? I can assure you of a strong effort from this Administration.

The President has been earning the reputation for credibility and perseverance the hard way. When he came into office, he said he would slow the increasing momentum of inflation. Others said the inflationary thrust could never be contained without a virtual takeover of economic activity or a major depression. It was, and without either.

The decisions were not easy to make. The cutbacks required to balance the full-employment budget and the degree of monetary restraint necessary to slow the inflation were not popular. But now we can see a reduction of the rate of inflation.

A portion of the battle against inflation is now over; time and the guts to take the time, not additional medicine, are required for the sickness to disappear. We should now follow a noninflationary path back to full employment, assessing developments as we go and ready to provide stimulation as needed.

But, the temptation is there to go overboard on excessive stimulation. These pressures exist on both the monetary and budgetary fronts. We must again provide the steadiness to resist these pressures.

The effects of balanced stimulation appear to be taking hold. Interest rates have fallen sharply and, as is usually the case, new housing starts have increased substantially.

As you all have also read recently, the increase in gross national product from the fourth to the first quarter was the largest absolute increase in history. Although we can't recover from an auto strike every quarter, we expect solid increases in output for the remainder of the year.

These facts, along with a policy of "steady as you go" have been accompanied by an unprecedented rise in the stock market. It was just about a year ago that the President suggested that it might be a good time to buy stocks. Stocks are up about 30% from the time he made that statement.

The facts reviewed here do not suggest a sharp departure from prior experience. Perhaps the only significant departure is the "steady as you go" policy. A colleague of mine at the

University of Chicago, in a recent Newsweek column, said the major threat to prudent management of the economy is the "For God's sake, let's do something" philosophy. I think there is a great deal of merit in what he says.

Government does have the responsibility to remove artificial props to wages and prices when the free market system is abused. And in selective cases, in a critical industry, or in an especially flagrant situation, Government should be willing to be the catalyst in achieving voluntary stabilization, and, when necessary, to help restructure the bargaining process.

But we will not be drawn into a series of steps that will lead to wage and price controls, rationing, black markets, and a loss of the effectiveness of the free economic system.

A single theme runs through everything this Administration does. In foreign policy, our Government will help others help themselves, where they are willing to bear the major portion of their own defense, and where it is in our national interest to help. In domestic policy, the Federal Government is moving to help people more, in a way that returns power and responsibility to States and localities. And in economic policy, the Federal Government will seek to create the climate in which a free economy can expand steadily and solidly, without domination by Government.

There is a consistency to this philosophy, a balanced approach that permits the diffusion of power in the foreign, domestic, and economic areas.

Those of you familiar with sailing know what a telltale is -- a strip of cloth tied to a mast to show which way the wind is blowing.

A captain has the choice of steering his ship by the telltale, following the prevailing winds, or to steer by the compass.

In a democracy, you must keep your eye on the telltale, but you must set your course by the compass. That is exactly what the President of the United States is doing. The voice from the bridge says, "Steady as you go."