ECONOMIC INDICATORS

Professor Martin R. Gainsbrugh

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Reviewed by: Colonel Tom W. Sills, USA

Date: 29 September 1959

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

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GENERAL HOUSEMAN: So far in your course on the Basic Review of Economics, you have been given a variety of basic information. You have covered economic principles; you have touched on certain factors which are important to the American economy; and you have been exposed to information on the natural resources which are important to the American defense posture.

There are certain other things which you should know, and this morning we are going to take up the subject of graphical and statistical Economic Indicators. I understand you have all been issued this particular document or brochure, "Economic Indicators," which will be used as a basis for at least part of the period this morning.

Our speaker has been invited here because he is an expert in this particular area of indicating and discussing this subject. This is his sixth time before Industrial College audiences because of his specialty in this particular area.

Professor Martin R. Gainsbrugh is the Chief Economist for the National Industrial Conference Board. This is the organization which has been a pioneer in the study of basic indicators which will enable business men, government leaders, and others interested in trying to forecast busts, booms, or the way the economy is going in the future.

Professor Gainsbrugh has displayed an interest in this College by coming here six times, but he also is a member of the Board of Advisers for this College. Professor Gainsbrugh.

PROFESSOR GAINSBRUGH: I am delighted to be with you again this morning. The bugles blew a little earlier than usual.

I propose to speak with you about the three questions involved in the business outlook as of late September 1959, using as the basis for my conclusions and for my analysis the flow of current economic intelligence contained in the document which you all by this time, I hope, have before you. We will be absolutely lost without (a) "Economic Indicators," (b) a sharp pen or pencil so that we can post some of the more recent figures that will help us to get a determination of our current position; and (c) at least in my instance, 20-20 vision, whether artificial or otherwise.

Keeping in mind the escape of time, I have clearly fixed in my mind the admonition given me in a talk in Texas not so long ago by the chairman--the challenge Texans now give to every business analyst or economist who presents his views to a Texas audience. It is this: "If you don't strike oil in the first 30 or 40 minutes, quit boring."

I said there are three questions involved in the business outlook, and we have assembled in "Economic Indicators" materials bearing on all three questions. I commend these three questions to you for use in appraising problems involving the outlook for an individual firm, for a region, and for a community, as well as for the Nation.

The first question invdved in the outlook, on which the material contents in "Economic Indicators" are helpful in this connection, is: Where are we? Just how bad or how good are things after 70 days of inactivity in the steel industry, for example? It is not always easy to get a fix on our current position. Too frequently individual emotions get in the way, or the limits of perspective of the individual. He sees the Nation in terms of those events or statistics which are close to his own interests.

I was in Washington in March or April of this year when parades of the unemployed were being organized in the belief that the problems of mass unemployment of a mature, stagnant economy were back with us as we entered the sixties in the same way that they had been with us in the thirties. It is not always easy to get an accurate determination of where the economy stands at a given moment of time. We shall try, on the basis of the data contained in "Economic Indicators." That's the first question.

The second question involved in the outlook that I propose to explore with you, using "Economic Indicators," is: How did we get where we are? What are the forces, beginning in April of 1958, which gave us month after month of unbroken recovery, so much so that, by April or May of 1959 we moved from the cyclical phase of recovery into the next gratifying phase of the business cycle, the phase of prosperity in which we find ourselves right now and in which I think we will continue to be for many months to come. What are the forces which produced this recovery and broadened it and deepened it so that recovery was transformed into prosperity? Can they be identified? Again, using the materials contained in "Economic Indicators," I think we can throw some light on that question.

Then, finally, and this is perhaps as challenging a time as any I have faced with this audience, the third and last question: On the basis of our appraisal of where we are and how we got where we are, what is the outlook for the months immediately ahead, in the face of the uncertainty surrounding labor-management relations, in the face of the uncertainties which characterize operations down at the lower end of Manhattan in recent weeks, and in the face of international uncertainty?

This is a hazardous occupation, dealing with questions surrounded with such imponderables. Nevertheless, business must plan for the weeks and months immediately ahead. Governments, too, must plan, and consumers, too, plan. And so, hazardous as is the answer to the third question, we will explore that, using some of the tools again, presented for your guidance, in this invaluable document, "Economic Indicators."

I might tell you a bit at this point about the origin of this document. It was brought into being shortly after the Employment Act of 1946, shortly after the creation of the Council of Economic Advisers and the Joint Economic Committee. The members of the Council and the staff of the Council, in typical professional style, looked at the economy, using the flow of current economic intelligence available to them—the organized body of statistical information and the charts presenting the results of this statistical information in organized form.

Word got around that the Council members, or the Chairman of the Council, was taking these charts along with him when he briefed the President or other members of the Cabinet as to the state of the economy. So members of Congress asked if they, too, couldn't see what it was the three Wise Men in Washington were saying about the current state of the economy and its prospective position.

So gradually this document became a public document. It is now available monthly, one of the most sought-after documents to come out of Washington, and one of the biggest bargains in this era of inflation at \$2.00 per year. For \$2.00 per year, you can see exactly what it is the Chairman of the Council of Economic Advisers is telling the President of the United States and the members of the Cabinet when he briefs them week by week and month by month on the state of the economy.

Well, look with me, first, at the Table of Contents, and see the facets of information covered by organized statistical data--shorthand that economists and statisticians use for the communication of fact. You have become intimately acquainted with some of these measures in the days preceding this lecture. One of the greatest single contributions the economist has made to inform business, individual, and community judgment is the development, on pages 1 through 10, of an organized system of national accounts. I commend these to you heartily. The greatest single invention of the past quarter-century in the field of the social sciences perhaps was the development of the information contained on page 2, the gross national product or its expenditures. Stay with the Table of Contents--I am just highlighting some of these. Andy Kress and Gerhard Colm have already spoken with you about that particular measure. Then, in addition to that, you see the other broad headings--Employment, Unemployment, and Wages; Production; Prices, et cetera.

I propose to use some of these measures. There are 32 pages of economic indicators, and I can't possibly begin to discuss them all. I propose to use six of them as thermometers, as the best indicators that we have of current position. You might want to label on the Table of Contents the following as being thermometers that business economists, as well as governmental economists, and top management and middle management, more and more, appraise and analyze intensively in trying to get a more accurate picture of our current position.

Such thermometers embrace, page 2, Gross National Product. That's an excellent thermometer, the best measure of total economic activity that we as a people thus far possess. The second thermometer, the second measure, of aggregate economic activity, page 4, is Personal Income. As you know, consumers even at the moment have more money, despite the steel strike and the economic losses of the steel strike, far more money, at their command than they had a year ago; and they are spending as freely as they were a year ago.

Gross National Product, thermometer No. 1, and Sources of Personal Income, theremometer No. 2, page 4--these two you have already covered, without question.

A third one that we will look at is Status of the Labor Force: Employment and Unemployment, page 11.

A fourth one--and this one I will start with--is Industrial Production. This is in many ways the most highly respected of all of our measures of current position; for this very good reason--that the index of industrial production was in the primers that were used by top and middle management when they were taking echo 1 and echo 2. They understand it, they are familiar with it, and they have great confidence in it. It is also put out by the Federal Reserve Board, and to business that means that it is still on a gold standard. That's the fourth thermometer.

And the fifth and sixth you have been concerned with in the lectures immediately preceding mine--the Price thermometers, pages 23 and 24. They are helpful, and we have made great progress in speeding up the flow of current information. We need to do a much better job in some areas, but, in the aggregate, we spent many years and much of public and private funds in developing and improving the flow of current economic intelligence.

Now, to whet your appetite, on this Table of Contents there are also indicated measures which have high barometric value, which throw some light, but better light than we have been able to have in the past, upon the future course of operations of the economy. I propose to deal, in the time available to me, with about a half-dozen of these barometers, as distinct from thermometers. Let me identify the six barometers for you.

Barometer No. 1--and it's having its influence steadily throughout this year in terms of business decisions--is Corporate Profits, page 8.

Barometer No. 2 is Intentions to Invest in New Plant and Equipment, page 10. This is a highly sensitive indicator, one that typically turns down well before business turns down and typically turns up well before business in general turns up.

Average Length of the Work Week is on page 13, and, in the face of the steel strike, how gratifying it is to tell you that the average length of the work week rose again in August, and undoubtedly is rising again in September. That's the third of the barometers.

The fourth barometer is Construction Contracts, page 19.

The fifth barometer is Housing Starts Today, and our expenditures for construction tomorrow and tomorrow and tomorrow--a leading series—page 20.

The last one is New Orders, particularly of the durable goods industries--Sales and Inventories. Really, to be accurate, the Table of Contents should say, Sales, Inventories, and New Orders, Manufacturing and Trade.

There is another one here, but I will simply refer to this one in passing, without comment. Some of you have already asked about it.

The seventh barometer, without comment, is on Page 30, Stock Prices.

Let's examine first the thermometers and what they tell us about our current position. We start with page 16. While you are finding that page--this is a measure of the physical—stress the word "physical" and underscore it--the physical output of the Nation's factories and mines. You don't get bogged down with changes in the purchasing power of the dollar in the use of this particular measure—the physical output of the Nation's factories and mines. If by this time you have found page 16, you see charted on page 16, up at the top, the course of the output of the Nation's factories and mines through the month of July. You'll notice one general characteristic of the lines on the chart, whether they be for total industrial production, for durable output, or for soft goods output, nondurable. Somewhere in the months of April or May or June or July these indexes broke into new high ground, moving us from the stage of recovery, which began, as I told you, in all instances, back around April 1958. You see the big V there. You could almost call

1958 the year of the big V, particularly for the capital goods industries, for the durable goods industries. By mid-1959 virtually every component of the index of industrial production, particularly factory components, was into new high ground, moving us from the recovery phase of the business cycle into the prosperity phase.

The prosperity phase of the business cycle is very quickly defined. It is that phase of the business cycle in which we move into new high ground in terms of physical output, in terms of employment, in terms of personal income, and in terms of corporate profits. You know the happy phases which mark the stage of prosperity.

Let me tell you one other thing by way of historic perspective. The prosperity phase is the last and final phase of the four stages of the business cycle. It runs its course as do all of the other phases of the business cycle. This prosperity will run its course as have all past prosperities. We build up stresses and strains in our society during the prosperity phase which ultimately bring it to its close.

Prosperity, the final phase, is followed by the initial phase of the next cycle, contraction; then contraction runs its course and becomes either recession or depression; then recession or depression is replaced by expansion; then expansion begins and runs its course and becomes either recovery or prosperity.

We find ourselves now in the fourth and last phase of the business cycle. Examine the history of the United States and you will see how important it is to have this organized statistical information at our command, particularly the national accounts, stretch back over a century or a century and one-half. Examine it intensively as has the National Bureau or the National Industrial Conference Board, or some of our other research institutions concerned with the problems of the business cycle, and you will find that this prosperity phase, which I say is clearly identified for you in terms of output on page 16, once begun, runs its course, the average length of that phase of the business cycle, as best it can be measured, in around 12 to 18 months. This one began in April or May of 1959; so, if you believe in mechanical approaches to the business cycle, you know that this prosperity phase, too, will end. But, even in the face of the steel strike, there are massive forces at work that might conceivably continue this phase of the business cycle for months to come. In my mind--and I will document this as best I can--we face the prospect of one of the longest phases of prosperity, in a cyclical sense, that we have had since the end of World War II, or perhaps at any time in our history.

Well, all of this, then, is by way of whetting your appetite for just one of these measures, the index of industrial production and what it tells us about our cyclical position. It also throws some light on our short-term position, because I can now give you to post on page 16 the August figures, and I can even hazard a guess as to what the September figure may be.

Steel is important to the American economy. Steel carries a weight in the industrial production of around 3 percent of the 100 percent total. Steel accounted for around 7 points of the 155 points that you see as the all-time high of the index of industrial production back in June. The August figure--that was a month characterized by 12 percent output in the steel industry—despite all the moaning and wailing that went on, was 149. As you will see, that's above the pre-recession peak, if you look back--historic perspective. Even without the contribution of the steel industry, the physical output of the Nation's factories and mines in the month of August was 149. And we believe that when the September figures come out, in the face of the headlines that we have been seeing about the closing-down of some plants in Pennsylvania and that possibly one of the big three may be facing some steel difficulties in the weeks immediately ahead, even so, the September figure may be around 145--pretty close to the pre-recession peak of industrial production, which was reached in February of 1957 at 146.

The steel strike is biting into the physical output of the Nation's factories and mines, but this is a huge economic system, and in many areas of our economy physical output is continuing to break into new high ground in the month of September as it did in the months of July and August.

Now, on page 17, just by way of documentation of what I have been saying, you can trace the course of physical output of some of the major industries. See the story as it is unveiled for you on page 17. Primary metals in the month of July went down to 113 from its all-time peak in the month of May at 154. But fabricated metal products are at an all-time high, in the month of July. Machinery output is at an all-time high. New high ground—a documentation of the prosperity thesis in the month of July. The sick needle trades that some of you have heard about were at an all-time high--textiles and apparel--in the month of July. An industry that lagged in its recovery pattern for a while, the chemical industry, in the months of June and July was at an all-time high. We are eating more and drinking more than ever before. The July and August food figures are at an all-time high.

The steel strike is masking the prosperity phase that is present in virtually every other sector of the economy, except for those sectors that are affected by steel shortages and will be affected increasingly.

Well, I have made one point, then, in connection with this particular measure of industrial production. It reached its low in April of 1958. We had 12 months of unbroken recovery thereafter, and by April or May or June of this year we moved, on the basis of this measure, from the phase of recovery into the phase of prosperity.

A quick, fleeting reference, now, to a second thermometer, fleeting because you have already been exposed to it by Gerhard Colm--page 2, total national economic activity. These figures are already familiar to you. This is the dollar value of the Nation's total output of goods and services--not just what is turned out in the factories and mines, but what goes on in agriculture and construction and government and retail trade and every form of activity in the country. You might want to post on page 2, just for purposes of long-term perspective, the figure for the gross national product, the second column here, for the year 1959. We used to be, gentlemen, a $90 billion economy. That's what we turned out in the course of a year prior to World War II, a $90 billion economy. We've gone from a $90 billion economy to--you see the figure for the second quarter--a $484 billion economy, a multiple of well over 5, between 1939 and 1959.

You see, too, further confirmation for what I have said earlier, that, in terms of the dollar output of the Nation's enterprises, we are now in new high ground; and we are of the belief, even in the face of what has happened to this economy because of the steel strike, that when the third-quarter GNP figures are released--and we are coming now to the close of the third quarter--the figure that will emerge will be $485 billion of gross national product. We are further of the belief that in the fourth quarter we will break into new, new high ground, and that in all likelihood--and this is what private business economists are telling top management in terms of planning for the months immediately ahead--and they literally are on the firing line if they are wrong too often--that can't be said of all the members of the economic fraternity--some of them have tenure--but this particular group has to be right more often than not--we had better getting used to a new system of numerology--the trillions rather than the billions; that by the end of this year we will have for the first time moved into the half-trillion-dollar level. Visualize the fun economists will have when we start rounding everything to the nearest tenth of a trillion, rather than, as on page 2, to the nearest tenth of a billion.

Now, there are some skeptics out front, as there are in every audience that I recite these figures to, who say, "Of course this has happened, and it's primarily a reflection of the process of inflation, and there will be very little economic growth left after you take correction for this process." You might also want to post on page 2, therefore, for purposes of historic perspective, the figure of about $200 billion dollars in terms of today's prices for 1939 output. That's how much more the dollar bought in 1939 than it buys today. But it is also a way of taking cognizance of the toll of inflation and still getting a measure of the economic growth of the past two decades. We've gone from a $200 billion economy in terms of today's prices to a $500 billion economy. Even after allowance not only for inflation but for population growth--we had 130 million people back then; we today have 177 million people--our per capita GNP is some 70 percent higher in real terms--70 percent higher in real terms--than it was in 1939. I stress all of these because a hostile critic of economic growth is in our midst and hits the headlines these days. There is something to be said for the record of growth of our society, too, I think.

That was another thermometer in further support of the thesis that we have moved into the prosperity phase of the business cycle. Now let's turn to the third thermometer, and here I have to start picking up the pace so that there will be some time left for the barometers. On page 11 there is the employment-unemployment thermometer. How wonderful it is to hear that wave of sound out front, the rustle of leaves. On page 11 the July figures are posted in your "Economic Indicators." The August figures are already out. The good news of August, in the face of the steel strike, was that non-agricultural employment, as best it could be measured--non-agricultural employment--was 60.9 million in the month of August; 60.9 million non-agricultural civilian employment. And unemployment was 3.4 million. Recall the discussions that went on in March and April about the problems of a mature economy and chronic unemployment, characterizing the U.S.A. The unemployment figure in the month of August was 3.4 million. Compare it with the figure of 4.7 million a year ago.

There is room for further growth in the months immediately ahead if ever we resolve our labor-management difficulties. I must add a fact that some of your leaders of discussion would stress if I didn't. In our treatment of the unemployed, those on strike are not counted as unemployed. They are voluntarily out of work rather than laid off because of scarcity of jobs. This is the official treatment of the strike figures. A year ago in August there was 7.6 percent unemployment. See the column labeled Percent of Civilian Labor Force Unemployed, Seasonally Adjusted--recognizing that in the months of August and September and October jobs are easy to get. A year ago 7.6 percent of our labor force was unemployed. In the month of August this year, in part because of the difficulties arising from the steel strike in other industries, 5.5. percent were unemployed. That is a little higher than is typical in the phase of prosperity. It has its negative as well as its positive aspects. It suggests to this observer that in the months of the fourth quarter of 1959 and in 1960 there will be slack in the labor force, which might enable us to step up our physical output even higher without straining those resources. However, this is a thermometer that gives you a mixed reading.

I am going to skip now, for reasons of time, to the last thermometers, pages 23 and 24, the price thermometers, because, again, there is so much of value to be gained from even a quick inspection. First, on page 23, the prices paid by consumers--your wife and mine--for the goods that are bought at retail. And the very gratifying news about this recovery which began in April 1958 and is still continuing is that this has not been accompanied by the same sort of price increase which characterized the system from the end of World War II until about 1957. Look at the consumer price index and you will see that—using page 23--starting from the month of May 1958, there was virtually no change in the consumer price index through the month of March 1959. There have been now four months of successive increase in the consumer price index. The July figure that was released was around 125. But, even so, all that has happened over this period of time, then, is less than a 1 percent increase in the consumer price index, even though consumers in the main believe that prices have continued to advance markedly over the past 12 or 18 months. We heard much about the fact that prices failed to decline in the recession. We have heard all too little about the stability of prices in this phase of recovery and prosperity.

Again there are some skeptics out front. Much of the rise in the consumer price index in the last three months was seasonal in character and will wash out. By way of confirmation look at page 24. This perhaps is of even more intense interest to the service groups. The wholesale prices, the prices charged by manufacturers for their finished goods--how many of you knew until you were introduced to this body of data--have been declining for the past four months, and they were again markedly stable ever since this recession began. The month of April, as you see on page 24, was 120; May was 119.9. Go down the list and add thereto the figure for August of 119.1.

Even more in point, look at the index of price performance for products other than farmstuffs and foodstuffs. This is the one that business men watch intensively, because they have so little control over the farm area. Note the stability which began to develop in industrial prices somewhere around March and April, even in the face of the recovery-prosperity pattern to which I have referred. The August figure was 128.4, exactly the same as July.

We have made progress in our battle against inflation. I don't say that we have won the war against inflation, but I am saying that the price theremometers continue to make very good reading right through the month of September 1959.

So much, then, for the thermometers. They show us the extent of the recovery, the movement into prosperity, prosperity thus far without inflation. Now for the barometers--and here because of reasons of time I will perhaps have to confine some of my comments to the discussion period. But let me start with the single most significant barometer, the one which leads more and more business economists to subscribe to the continuance of prosperity through the balance of 1959 and possibly all of 1960. This is page 8, the corporate profit figure. Corporate profits bore the brunt of the recession. If you will look at the figures on page 8 you will see that the retained earnings or undistributed profit dropped down to $3.6 billion in the first quarter of 1958. They had been as high as $11 or $12 billion in some of the early quarters of 1956 and 1957. Then witness the improvement. First quarter (1959) profit figure is 46.5. The figure is yet tobe released for the second quarter, but our guess is that when the corporate profit figure is released for the second quarter it will be at least $50 billion and may be as high as $52 billion. Corporation after corporation, disciplined by the recession, cut its costs, improved its margins, and became a healthier, more viable body, and emerged from the recession as a more efficient organism.

Why do I stress this as a barometer? The improved profit position of American industry is leading corporation after corporation to take out of the deep freeze its programs for investment which were put therein in 1956 and 1957. We face the prospect of a completely different pattern of capital investment in the months ahead from the patterns of capital investment from the end of the war until 1956 and 1957. The primary motivation of the early pattern of investment was to expand capacity, to bring capacity up to market requirements. In the steel industry, in the automotive industry, and in the chemical industry we were short of capacity. We were paying the price for the great depression of the thirties and for the restrictions placed upon private industry's expansion during World War II. We and the rest of the world were engaged in a rush to expand capacity up to visible market requirements. There was a clear-cut terminal point to that expansion program, and we reached that terminal point, in many instances, in late 1955 or early 1956. It became more and more visible with each passing month in 1956 and 1957.

Now, as we come to the end of 1959 and enter 1960, there are still many industries that have more capacity in being than there is market demand. This is true even of our steel industry if and when it goes back to work. There may be a rush to rebuild inventory, but the existing capacity is in all likelihood greater than the market requirements. Yet let me tell you that the steel industry, in the first quarter of 1959, appropriated a half-billion dollars for new plant and equipment.

We at the Conference Board have developed a new tool, a new barometer, a new foreshadowing statistics, the capital appropriations of the thousand largest manufacturing corporations. We figuratively plant a microphone in the Board of Directors rooms of General Motors, U. S. Steel, Standard Oil of New Jersey--you name them and we have them--and we listen to their plans well in advance of the subsequent commitments or expenditures. Because of their improved profit position and their increased cash flow, giant company after giant company is appropriating money, even in the face of the steel strike, for further investment--not just for sheer capacity--this is the point--but on the dominion side of the equation rather than on the capacity side of the equation--new product development, research and technology, product differentiation, plant relocation to bring the plants closer to new markets, plant relocation to bring the plants closer to more economical sources of supply--all designed to intensify and deepen and capture dominion, to improve the product, to give greater value, and possibly at some later time to offer lower prices along with greater values.

This type of investment has no clear-cut terminal point. This type of investment may prove far more self-generating than the type of investment which went on from the end of World War II until 1956 and 1957. This is a new state, a new set of conditions, in which we and the rest of the world find outselves, with more capacity in being than there is market requirement, and yet with intensive investment developing nevertheless--so much so that we reported that in the second quarter of 1959 these corporations, the thousand largest corporations, increased their capital appropriations by 41 percent over what they were a year earlier; and capital appropriations today become expenditures for new plant and equipment, not tomorrow but 6, 9, 12, and 15 months from today.

What this barometer then is suggesting is that, as some of the forces which were potent in the recovery lose their potency--and they may, as the housing boom tops out--that was one of the forces making for recovery--as the rapid extension of consumer credit conceivably tops out in 1960, as some of the stresses and strains develop in our society which typically lead toward the end of prosperity--a new, sustaining, broad force will become increasingly operative. That is the force of private investment in new plant and equipment, and this then may give further life and substance to the prosperity phase which began in April of 1959 and which many business economists believe will run, not only through the fourth quarter of 1959 but through 1960 as well. The most frequent figure that is now being used for business planning purposes--and this is a good way to close, by way of challenge as well as by way of communication--for the year 1960 is the gross national product figure of $525 billion. The year 1960 will be a 5-percent year, with a somewhat lower rate of growth than the rate of growth in 1959, with a greater prospect of a continuance, to repeat, of prosperity without inflation--prosperity without inflation--than we have had at any time since the end of World War II.

With the exercise of just a wee bit more discipline on the labor front and on the governmental front, we face the prospect of better times in the months immediately ahead.

COLONEL REID: Professor Ganisbrugh is ready for your questions.

QUESTION: Sir, would you mind discussing your No. 7 barometer, stock prices?

PROFESSOR GAINSBRUGH: I have almost a fixed position in response to that question. I usually state that if I could answer that question my office would be at the tip of Manhattan instead of in the center of Manhattan. I would suggest that you look, by way of at least provoking discussion, at page 30 at your leisure and see where stock prices were some time back, not too far back, where they were at their peak, and then relate those prices to the earnings of America's corporations and to the interest rates that can be achieved in other types of investments. You might then come to a feeling, as did some economists in the center of Manhattan, that there seemed to be little relationship any longer between security prices, the course of profits, the rate of growth of the national economy, and the alternatives available to individuals in other forms of investment. This was the growing spread between what could be earned on securities, with all of the risks involved in such securities, as compared with what could be earned on bonds, with all of the risks involved in bonds.

I think part of the pricing of the security was affected by the outlook for further inflation. It was also affected by the rates of interest that were available here and elsewhere. And I think the economic scene has begun to alter, in terms of the diminution of inflationary pressures, not only here but worldwide. Per Jacobsson, one of the most distinguished students of financial affairs, speaking in Sweden just a week ago, made the same point. The capacity position of the world in industry after industry is such that, coupled with the increasing resort to tighter central bank policy, the inflation potential of the future is far different from the age-of-inflation picture which was painted--and rightly so, perhaps--from the end of World War II until the present.

I could, if time permitted, enumerate at least 6 or 7 factors which make for less inflation in the future than in the past. The bulk of our war debt is behind us; that's certainly one factor to be kept in consideration. The liquidity of our society today is far different from the easy liquidity of the first 10 or 15 postwar years. Foreign competition is far ;more intensive than it ever was. One of the most disturbing economic statistics contained in "Economic Indicators"--examine it at your leisure—is the deterioration in our foreign trade position. For the first time in many years, in the month of June, our commercial imports exceeded our commercial exports. Notice I stress "commercial." We face the prospect of another loss of around $3 billion or $3.5 billion dollars in our international balance payments series.

This, too, is known to American manufacturers, and they are far less agreeable to wage cost price hikes than they were in another era in which capacity shortages existed and there was an easier pass-through in the wage cost price calculations.

These are all factors to be kept in mind in appraising the outlook for inflation. I think some of these factors, coupled with international uncertainty, coupled with the steel strike, itself, and its impact on the profit position of many of the companies in the third quarter, when those figures are released, lead to some degree of correction.

Well, I didn't mean to respond as fully to that question. I still end where I began. I know very little about this animal.

QUESTION: In reading last night I came across this particular paragraph. It said, "When the wave of expansion loses its force, or when banks run short of reserves, interest rates will tend to rise and new loans will decline in volume, and eventually business will decline." Then it went on to say that this would be accompanied by a contraction of the money supply. Isn't that what we are running through now, and isn't that in conflict with some of the indicators that we see today?

PROFESSOR GAINSBRUGH: The descriptions that you read are the traditional descriptions of the closing phases of prosperity. This is one of the reasons why, in the prosperity phase, growth, although it continues, is a slower rate of growth than in the recovery phase, particularly in a recovery after a rather acute recession. And let no one tell you that because the recession of 1958 was short-lived it was mild. While it lasted it was the most intense--in those 8 or 9 months--of any we have ever had. We have forgotten that the steel industry, about 15 months ago, was operating at around 45 percent of capacity. While that recession lasted it was intense. You would expect a rapid rebound in the recovery phase, but then you get this slowing up of growth in the prosperity phase.

Now, interest rates are being hiked. Will this slow up the expansion curve along traditional lines? My argument is that it will not, as rapidly as in past phases of prosperity, for the reason that, in most instances, these investment decisions are unilateral rather than bilateral or multilateral. I stress the improved cash flow of America's corporations which some ofyou have seen in the latest capital figures for the second quarter, and they are improved again in the third quarter. These industries not only have their investment plans already drawn but they also have at their command the wherewithal, in most instances, to finance this internally, rather than to have to go outside for expansion. As much as 80 percent, possibly, of the total expansion program envisioned for the next 12 months would come from internal rather than from external sources.

I think, too, that the profit-making capacities of these plans are such that a hike in interest rate will not, as yet, begin to exercise much of a restraining influence. When we announced the results of our latest survey in News Week, News Week sent out stringers to corporations across the country to talk to them about this expansion process. They asked Tex Thornton of Litton Industries, for example, whether the fact that the prime rate had gone up would be of much moment in the expansion program of that industry. They could have asked the same question of Eric Johnson of Texas Instruments. The answer they gave is, "We think in terms of profits, profit potentials, of the magnitude of 10, 15, and 20 percent, and a half of one point or a one point rise in the interest rate would therefore not be the major question in terms of our investment programs."

I think what tighter money may well do is to shake out of the market some of the marginal types of investments, to make it more difficult for the hazardous types of investment to find financing. But in the case of the investment programs of the type that I have described for you, most of the funds are to hand and will not be unfavorably affected by our monetary program, I believe.

QUESTION: You indicated that the steel strike is beginning to have some effect on industry overall. There are some indications that a railroad strike might come up in November. What would be the cumulative result of this, in your opinion?

PROFESSOR GAINSBRUGH: One of the stresses and strains that have accompanied past periods of prosperity is increasing labor difficulties, and I think that we are facing that same pattern of stress and strain now. This is not unusual in our society. We've had labor-management difficulties in the past. Retrospectively--this is just one man's opinion--I often think that the resolution of these labor-management difficulties within the traditional market methods has been more in the Nation's good than resolution of those difficulties by any other device outside the market mechanism.

Now, I think, if a pattern of national strikes across the country were developed, we would have to throw the book away and start again in our appraisal, and restudy our economic indicators. But I also know this, from the record of history, that no strike, or no series of strikes, thus far--and this would span a century or a century and one-half--ever reversed the pattern ofthe business cycle. We haven't gone from prosperity to recession as the result of a strike or a series of strikes. There are massive forces that make for the business cycle and its characteristics. I can find no precedent in American history for the belief that labor uncertainties late this year or early next year could move us quickly from one phase of the business cycle to another.

I also direct your attention to still another fact. We do have a Taft-Hartley Act on our books and, should an emergency arise, labor could be asked politely to go back to contributing to production. Now it is frequently said that even this might not work. I think that, when the national interests are so much at stake, we can count just as much on labor cooperation as on the cooperation of any other group.

In addition to that, if you read the Taft-Hartley Act intensively, you will find that the President, at the close of this period, even after the last offer has been voted upon by the employees, can then make recommendations of his own for settlement.

I have been exposed to more bearish questions over the past week or the past two weeks, I guess, than at any time in the last 2 or 3 years. This is one of the types of bearish questions. Another one is: What if peace breaks out tomorrow, in terms of its implications? A third is: See what's happening to the stock market. These are not unique questions at this stage of the business cycle. This is the final stage of the business cycle. And the jitters axis will be busy throughout the length and duration of this phase of the business cycle trying to probe for weaknesses, and we well might—all of us. This, too, will run its course as has the past. These are tools that will be helpful to us in that connection.

But, if you grow too blue about the outlook, remember what perhaps I have said to past groups as well as to this one: This Nation has been on the brink of disaster ever since it was founded.

QUESTION: We read with concern what some members of the profession think of the growing and outstanding consumer credit. Would you care to comment on this as an economic thermometer or barometer?

PROFESSOR GAINSBRUGH: Yes. It is a favorite pasttime, I think, of some commentators to point with despair at the tendency for America's youth, our young couples, to go into debt over their necks, and to talk about the ultimate day of judgment. This is another one of the favorite themes. We find--and I think this would be supported even by Federal Reserve studies of consumer credit--an indication of sound rationing of consumer credit, (a) on the part of the consumer himself, and (b)--and this is worthy of emphasis--on the part of the lender. There is a process of credit search. It is surprising how frequently, after a sale has been made by an eager beaver, the credit man starts exploring the asset-claim position of the borrower and discovers in many instances that the asset-claim position of the borrower, or even his income position, doesn't warrant credit, and cuts it off.

One of the banks in New York City has discovered that there is any number of people who would like to have lines of credit on a consumer-credit basis, a personal-loan basis, and then, resorting to credit check, they have thrown out a great many of them.

This is not an automatic process of extension of credit. This is an economic transaction, and in the main the record of the past, right to the moment, supports the thesis that consumer credit has been more a constructive than a destructive influence on our society. Without consumer credit I wonder as to the dimensions and scope of our consumer market, particularly of consumer durables, the big-tag items.

So far as the growth of consumer credit is concerned, remember that America's consumers grow better credit risks, that more and more of our society warrantedly resorts to debt. Debt is an extremely constructive process. Think about it some time. What's the other side of the savings coin if we didn't have the debt process at work as well as the savings process? Somebody has to borrow; somebody has to save.

I'll stop with that.

QUESTION: Going back to your statement on the capital appropriations of a thousand of the largest corporations, and so forth, theoretically large capital appropriations may be inflationary in that the productive goods do not start coming out during the time the wages and so forth are coming out. I notice that Vice President Nixon's Cabinet Committee Report on Inflation this morning had something to say about that, that corporate investments in 1955 and 1956 may have caused some inflation. Could you talk on that?

PROFESSOR GAINSBRUGH: Yes. The point that I think has been made is that some of the inflation of the 1956-57 period was the result of scarcity in the capital goods sectors, so much so that excessive demand, pressing upon limited supply, pushed up the prices for capital goods. That was not the condition of the American economy prior to the steel strike, with the exception of steel, itself. There was ample slack, let me assure you, in General Electric and Westinghouse for turbines, and some of you know of the layouts which went on in that particular area earlier. We have expanded the total capacity of American industry so that, even under the picture as of June or July, we were at only around 85 to 90 percent of capacity. There was ample slack.

I doubt very much that the type of investment program I envision, and the type that is being generated, will be as much of a potent force toward higher prices as was the rush to expand capacity in the first 10 or 15 years since the thirties. This is a more studied type of decision. More of this is going into research and development than it is into equipment or brick and mortar.

It is for these reasons that I think this will be a more orderly capital expansion program, with fewer inflationary implications, than was true in--I think it was--the Schultz thesis that was announced. As I remember it, it was the Joint Economic Committee Report rather than the Nixon Report.

QUESTION: Sir, you mentioned that one of your concerns in all of these economic indicators was the foreign trade imbalance, and you also mentioned the fact that the head of Litton Industries was not concerned about the rise of the prime money rate. Of course we have the strike facing us, and there was some indication made that there may be another strike. In your experience with these indicators, has there been any major indication that both the labor leaders and the industrial leaders understand the factor of the prime-money-rate rise and the cost-of-labor rise in trying to solve this foreign market problem? Are they using this material in that area? In other words, in our competition for the foreign dollars when the prime money rate rises it puts us in a relatively unfavorable competitive position, and when our labor rate rises it does the same thing. Are these people using this material to put themselves in a better competitive position in the foreign market?

PROFESSOR GAINSBRUGH: That's a very good question. I think our American manufacturers in the main belong to one of two schools--one school, particularly, of the two schools that have arisen relative to our foreign trade position. There are two approaches that are being pursued. One approach is the restrictive approach. Perhaps here I am repeating what Howard Piquet and some of the others have discussed with you. One is the restrictive approach--we can't compete abroad because of the tremendously lower labor costs and production costs that characterize parts of the world as compared with ourselves. The policies then become: Let's do what we can to hold down this competition from abroad. Quotas and tariffs are some of the restrictive devices. Their basic purport is to keep our imports below a dwindling level of export. That's ultimately where you come to. There are some in American industry as well as in American labor who would go down that road. Some of you may have noticed that the AFofL and the CIO, too, have grown concerned about this problem of foreign competition.

There is another school--and I think this is the school that is in the majority and is gaining recruits all the time--that says, "We must compete more vigorously for foreign markets, and what we must now do is to work toward conditions that will increase our exports even faster than our imports are increasing. We must let both rise. Let's not have any deterioration in our export position." How do you do this? In part you do it through making our system more efficient, more competitive, than it has been in the past, taking cognizance, among other things--and it's late in the day--that we must compete in world markets in terms of our price structure as well as compete in domestic markets. And we've given relatively minor consideration to that position in the last 10 or 15 years. We haven't been concerned about our dollar position. The sterling balance problem was someone else's problem and would never haunt this country. Well, we have discovered that we are on a gold standard internationally, if not domestically, and that the disciplines of the market place can be brought home to us internationally, if not domestically.

That's one of the ways--improve our competitive position and do something about increasing the exchange position of the U.S.A. price-wise. This is one of the restraints, I think, that are being exercised in the steel negotiations--a recognition of the deterioration of the exchange position of the steel producer in world markets. That's part of the problem.

Another part of the problem is to say to foreign country after foreign country, as we are now saying, via our State Department, "We want to be able to compete as vigorously in the British markets, in the Common Market, as we allow you to compete in the U. S. market, because of the deterioration in our exchange position." This, too, is taking place.

You referred to the hike in the prime interest rate and what this might do to our position in foreign trade. As you indicate, it may lead to some increase in cost, but I think, again, it is nominal, or marginal, rather than of great moment. What it may also do is keep more foreign funds in this country than we were able to do under our low interest rate.

I spent some weeks abroad with British and French economists. They, too, were concerned about the problem of the decrease in our gold supply and the attrition in our exchange position. They have a selfish interest in this, in part. We are carrying much of the world's defense burden. The improvement in Britain's exchange position and in its domestic economy is in part a reflection of the fact that they diminished their defense load and left us to carry more of it. They are concerned about what change might come about from this, if deterioration goes on in our foreign trade position.

The French and others are concerned about the problems of mutual aid. We give funds freely to the underdeveloped countries. What might happen if there is further deterioration in our balance-of-trade position in the months immediately ahead, if we as a people grow concerned about this problem and start tightening up our purse strings?

I think, as I see America's manufacturers, more and more of them are trying to put themselves in a position where they can compete more vigorously--increase our exports of domestically made goods—and this, too, is going on--and invest abroad, so that they can compete more vigorously in foreign markets and we will still be getting returns on the American investment dollar reflected in our balance-of-trade position.

COLONEL REID: Professor Gainsbrugh, I think we can say on this fall morning that you have certainly brought a breath of fresh spring air to a series of economic lectures. We certainly, speaking for the entire faculty and student body, thank you very much.

PROFESSOR GAINSBRUGH: It has been a pleasure.