THE CURRENT ECONOMIC OUTLOOK FOR AMERICA

Dr. Paul W. McCracken

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Reviewed by: Colonel Tom W. Sills, USA

Date: 30 March 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

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Ralph W. Bennett

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COL. SMYSER: General Houseman, Gentlemen: This morning we are indeed privileged to have with us Dr. Paul McCracken, who will speak to us on the subject "The Economic Outlook for America."

About a month and a half ago, last December to be exact, the top economists in the nation gathered here in Washington for a meeting of the American Economic Association. Without any doubt, the outstanding speaker at that conference was Dr. McCracken. His remarks were received with a great deal of respect, and the evidence of that respect is the fact that his remarks received nation-wide, front-page newspaper coverage and extensive discussion in economic circles.

At that time Dr. McCracken was cautiously optimistic. Since then the steel strike has been settled. We know the terms of the steel settlement. The year-end economic information and statistics have been compiled and released. So I think you will agree that this is an ideal time to focus our attention on the economic outlook for America. And I know you will agree that we have the most appropriate speaker.

Dr. McCracken until last year was a member of President Eisenhower's Council of Economic Advisers. Presently he is professor of business economics at the University o Michigan.

Dr. McCracken, it is a pleasure to welcome you and to present you to the students and faculty of the Industrial College of the Armed Forces.

DR. McCRACKEN: I want to say first of all that I am delighted to have this opportunity to be here today. In a sense I regard this as to some extent a deferred appearance, because about two years ago I was scheduled to be here for what I think would have been a somewhat similar situation; but the night before we had fourteen inches of snow, and that was apparently too much for Washington. Having lived both in Minnesota and in Michigan and in Washington, D.C., I presume there is some kind of significance to the fact that the only time I recall ever having been snowed out of an engagement like this was in Washington, D. C.

I want to direct my remarks today both to the short-run economic outlook for the country, and also make some observations about what I would regard to be somewhat longer-range or somewhat more fundamental policy questions and problems that are facing the American economy. First of all, however, let's confine our attention to the relatively short-range economic outlook, say, looking forward for the next calendar year or so.

I think it is always worth while in any kind of discussion of the short-range economic outlook first of all to raise the question, What ought the economic outlook to be? In other words, what kind of performance for the American economy in terms of expanding incomes and output would we regard as a reasonably appropriate kind of performance?

Now, it isn't possible, of course, to calibrate this kind of thing in absolutely precise terms. Nonetheless, I think there is something that can be said about it. We know, for example, that our labor force is going to be expanding at perhaps somewhat over one percent, recognizing, of course, that the annual changes fluctuate considerably, and there may be some substantial deviation in that increase from the long-range average for this period. But, in any event, we certainly need enough of an expansion of output to provide additional employment for the growing labor force. And that, if we can take our long-range figure, ought to be, as I say, perhaps 1 to 1 1/4 percent.

Now, so far as 1960 is concerned, we also ought to have perhaps another 1 1/2 percent increase in business activity--that is, in real business activity--in order to take up the slack in the economy represented by the somewhat excessive amount of unemployment which we had on the average in 1959. On the average the ratio of unemployment to the labor force last year was about 5 1/2 percent.

There are, of course, sharp differences of opinion as to what constitutes par for the course here. It has seemed in recent years that something like about 4 percent of the labor force is about as low as you can drive unemployment, because at that point then the actual unemployment consists to a substantial extent of essentially non-cyclical factors, such as people shifting from one shop to another, people newly coming into the labor force and not yet having found the job they want, and so forth. So that if we take 4 percent as something like about the floor below which it would be rather difficult to drive unemployment, then we ought to have about another 1 1/2 percent increase in output to take up that slack between the 5 1/2 percent of our labor force unemployed last year and this 4 percent which would be more nearly par.

Now, the remaining reason or the remaining factor which would make it necessary or desirable for us to have an expansion of output is, of course, the expansion in productivity or efficiency of our work force. This, of course, varies greatly from year to year. The statistics seem to imply that it has been on the average something like about 2 to 2 1/2 percent per year. But we are dealing with relatively small figures, and percentagewise the difference between 2 1/2 percent and 4 percent is a fairly substantial difference if we are dealing with income. But let's take the long-range figure of about 2 1/2 percent.

This, then, would give us at least a preliminary target, so to speak, as to what the economic outlook ought to be--an additional 1 percent of output to provide employment for the expansion in the labor force, an additional 1 1/2 percent roughly to bring unemployment down to the minimal level, and then about a 2 1/2 percent expansion in output essential to keep our labor force employed because of the improvements in efficiency and output per man-hour. So that we ought to have, in other words, something like a 5 percent increase in output from 1959 to '60.

Well, now, the key question to raise then so far as 1960 is concerned is, Will demand increase enough to provide a market for this 5 percent additional output? In other words, the question is not whether we will have the capacity to produce this additional 5 percent, because, quite clearly, we will. The question is, Will demand increase enough so we shall find markets for this expansion in output?

Now, around the turn of the year there was, I think, fairly general agreement that that would be the case. For example, the revenue estimates in the budget message presupposed a gross national product of 510 billion, as I recall it from the budget message, and the 1959 gross national product was 478. So this would have been something like about a 32 billion dollar expansion in GNP, in gross national output, gross national product, with roughly commensurate increases in personal income and corporate profits, which are, of course, the two key variables that determine the actual amount of revenue that you are going to get from any structure or system of taxes. In the paper that I gave before the American Economic Association about six weeks ago I had arrived at just about the same kind of conclusion.

Now, what was the source of these potential increases in the demand for output that seemed to be in prospect at least at that stage of the game? Well, I think they would rack up something like this: First of all, there was the expectation that 1960 would be a year of substantial accumulation of inventory--not only substantial accumulation of inventory, but substantially greater accumulation of inventory than was true last year, in 1959. To be specific, in 1959 the preliminary estimates are that we had an accumulation of almost 4 billion dollars of materials and goods and products in inventory; whereas it seemed quite probable that in 1960 that would be significantly larger.

Now, the basis for that expectation was this: There were, I think, two or three things. In the first place, of course, there was general appreciation of the fact that steel inventories and related inventories were low by virtue of the steel strike. But it was also clear that inventories seemed to be low relative to the present and prospective volume of business generally, not only in steel and related products, but almost right across the board.

My own very horseback computations were that if we were to have achieved by the end of 1960 the same kind of relationship between inventories and sales as prevailed at the end of 1955, then we would have to have something like about a 6-billion dollar accumulation of inventories this year, as contrasted with 4 billion in 1959. If, however, we were to achieve the 1956 ratio of inventories to sales, then we would have to have something like a 10-billion dollar inventory accumulation. In each case this would entail stepping up production schedules substantially further relative to the rate at which goods were being moved into final markets, so to speak, in order to effect this kind of further expansion and enlargement of inventory.

Now, the second pretty clear source of additional strength in the economy for 1960 had to do, of course, with capital outlays. This evidence began to emerge as early as last November. The McGraw-Hill survey of business expectations, so far as plant and equipment are concerned, the results of which were released at the economic outlook conference in Ann Arbor by Dexter Keeser, at that time pointed to about a 10 percent increase in business expenditures for plant and equipment

1960 over 1959. And, as Dexter Keeser pointed out at that time, there is a certain degree of myopia normally in this kind of thing. In other words, these preliminary estimates usually tend to understate a bit the degree of expansion which will actually occur. So that he felt that it wouldn't be unusual if the actual increase would turn out to be, say, 12 or 15 percent.

The evidence in the Department of Commerce surveys of plant and equipment expenditures would seem to point toward, broadly speaking, the same kind of result. For example, the prospective rate of spending on plant and equipment by businesses in the first quarter of this year, the estimate for which was made available in December, was already about 15 percent above the 1959 yearly average. In other words, at the beginning of 1960 we were already at a level 15 percent above 1959 for the year. So something like a 15 percent increase from 1959 to 1960 would seem not unreasonable under those circumstances.

Now, there seems to be considerable evidence that actually businesses are continuing to follow through on this sort of thing. For example, we know that new orders for machinery, and particularly new orders for the non-electrical industrial machinery--electrical machinery is a rather hybrid sort of concept, which includes a great many things that are not really strictly thought of in connection with business expenditures on plant and equipment--but if we take the item of non-electrical industrial machinery, we find that the new orders being placed in the fourth quarter of last year were 47 percent above the fourth quarter a year ago. Now, to be sure, the fourth quarter of 1956 was not very far out of the recession, which reached its low point in April, 1958; but, even so, there has been a very marked expansion in the actual rate of placement of new orders.

Secondly, we have the data from the National Industrial Conference Board surveys of capital appropriations. These data are, I think, a useful addition to our inventory of factual data pertaining to the prospective business situation.

Broadly speaking, what these data do, what this survey does, is to ask businesses for any quarter what their actual appropriations for capital outlay projects were, because this is an act which logically is antecedent, of course, to the actual expenditures themselves.

It has the additional advantage, incidentally, that if you are asking a business what it expects to spend, you are getting a highly informed opinion; and actually the results over the last 12 years or so for which we have the expenditure intentions data are reasonably reassuring--they have caught the turns pretty well, by and large--but, nonetheless, you are asking them to make a guess about something which has not yet materialized. But if you ask them about their appropriations, you are asking them about something which has actually occurred. You are more nearly getting actual factual material, so to speak.

Now, what do these show? Well, for the third quarter of 1959, which is at the moment the latest quarter for which we have data, the capital appropriations of the thousand largest manufacturing corporations showed the strongest second-to-third-quarter movement of any year for which we have the data--and they go back to 1955--with the exception of 1955 itself. To be specific--and I put it in these terms because there is normally a drop from the second to third quarter; but the point is that the drop was less severe in 1959 than for any of the other years , with the exception of 1955, when there was actually a very slight increase.

However, as you look at the data somewhat more closely, you will find that this drop is entirely accounted for by steel. And the fact that the steel industry was somewhat out of business in the third quarter is largely to be explained by non-economic circumstances, so to speak. And if you look at the manufacturing universe excluding steel, you would find that the second to third quarter movement was the strongest of any of these five years--'55 on to '59. And it is reassuring that, at least looking over this period, the turns in capital outlays have normally occurred some few quarters ahead of actual expenditures on capital outlays by businesses. And so this substantial further strength here is at least a harbinger of a pretty good year for capital expenditures of businesses for 1960.

Now, a third significant element of strength that had been anticipated for the economic picture is the expectation that Government spending would continue to rise. It is perfectly true, of course, that even around the turn of the year there was the presumption that most of the additional expenditures by the Federal Government would be in the nature of what might be called transfer payments, rather than actual purchases of goods and services. But, even so, it has an expansive effect on the economy, because it is at least putting additional purchasing power out in the economy.

The actual increase in the Federal budget you now know. In the budget that's actually put forward the expected expenditures for fiscal 1960 are 78.4 and for fiscal '61, 79.8, which is an increase of one billion, 400 million.

I would like to make this observation, though I suspect I am talking to people who know this situation much better than I do: We do need, of course, to keep in mind that the President's budget message, or that the responsibility of the President in putting forward his budget message, is not necessarily to make the most accurate forecast he can of what governmental expenditures will actually turn out to be in a certain fiscal year, in the fiscal year ahead. It's his responsibility in the budget message to put forward a pricing out of the program which he is recommending to the Congress. The Congress may, of course, not accept it. Therefore the results may turn out to be different from what he had anticipated; and to that extent any divergence between what is initially estimated and what finally happens is not to be considered a measure of the extent to which it was a bad budgetary figure.

Now, this, I think, is important as we look at the budget message in order to try to get some indication of what actually is going to happen to Federal expenditures in any year in question. In other words, the budget message is not strictly in that sense simply a tool of forecasting, so to speak.

So far as State and local expenditures are concerned, it is certainly true that citizens in this country are indicating that they are somewhat less than happy in their capacity as taxpayers with State and local governments. I would want to remind you again that I come from the State of Michigan. But it's almost inconceivable that we won't have something like about the same kind of expansion in State and local outlays in 1960 as we have had virtually all during the postwar period.

As a matter of fact, it is interesting, if you go back for the last five years, that not only have State and local expenditures increased every year, but the size of the increase has itself been increasing. For example, in 1955 the increase was 2.6 billion over the preceding year, in 1959 it was 3.8; and that increase rises progressively throughout the entire range. Now, even if we had only something like a 3 billion expansion from 1959 to '60, which would be significantly less than the 3.8 billion increase last year, it would still be a very sizeable one.

I would like to make this observation: that I do think we need to face up as a nation to the fact that the kinds of decisions which we have made in certain areas virtually have presupposed that we are going to increase the share of our incomes that we are going to allocate to State and local governments. Those third and fourth and fifth babies that have been fouling up our population projections entail something more than the obligation that the obstetricians see at the time these additions to our population statistics arrive. Unless people are making the decisiion that they don't really want these third and fourth and fifth babies given an education, and particularly given an education at the higher education level, if we really want, in other words, to have the same level of education that we had been anticipating at the time that the birth rate was somewhat lower, then we have to face up to the fact that this just does presuppose that we are going to have to allocate a larger percentage of our income for education and the other social services that State and local governments historically provide.

Now, if they don't, if we don't do it through the State and local government level, then it is simply a foregone conclusion that the result will be not by and large that these needs are not taken care of. They will be taken care of. The result will be that these things will get boosted up into the Federal budget. I think this is just inevitable. I think if I learned one lesson in the two and a half years that I was here observing this kind of process, it is that if those needs aren't taken care of where they have traditionally been taken care of, they create irresistible pressures to put them into the Federal budget.

I must say that during the first year that I was down here I was very much irked with my own city of Ann Arbor because they turned down a bond issue for additional schools. Ann Arbor happens to be a fairly rapidly growing city because it is virtually becoming a suburb of Detroit. I happened to be out there shortly after this bond issue was turned down; and on the basis of, you know, this kind of representative sample that you put together by talking to the people you happen to meet--I think I saw Bob Burgess here someplace, and I'm sure he would be appropriately

shocked at this kind of
/ sampling, or at least drawing any inferences from this kind of sampling--but, nonetheless--, I was interested myself at how frequently I would get the response: "Well, this was our way, you see, of registering that we want the Government spending slowed down."

My only response to what I would regard as these more trogloditic views was: "Well, of course, what you did was to vote for putting these things in the Federal budget, because these things are going to be taken care of. So you didn't stop it. You just voted to have them put in the Federal budget."

Well, so much for that self-serving sermon.

Now, to go on here, another prospect in the situation is that, after some deterioration for the last two or three years in our external trade, our international trade, there does now appear to be some prospect that 1960 may show some improvement. I'm sure you are all familiar with this general phenomenon. The deterioration in our balance of payments has at least had the advantage that it has given Americans quite an education on the fact that we do after all have a balance of payments--something that I suspect most of us were only vaguely aware of a few years ago, when an imbalance in our balance of payments was the other fellow's problem, not ours. Now, in 1958, as you all know, we ran a substantial deficit in our balance of payments, almost 4 billion dollars; and about the same last year. But the prospect seems to be for some slight improvement in 1960; and this ought to exert some upward pressure on the economic situation.

One would be a little happier about this more rosy prospect except for the fact that to some extent the improvement is going to represent essentially nonrecurring circumstances, such as the substantial delivery of jet aircraft, and the exports of cotton and certain agricultural products which happen to be reflecting special circumstances, among them, of course, the bad weather in Europe last year. But, nonetheless, the very rapid rate of expansion in industrial Europe and in Japan and in certain other areas that constitute important markets for American products certainly augurs well at least for some improvement in our external trade in 1960.

Now, it must be said that the consumer situation has reflected more cross currents. So far as residential construction is concerned, the expectation has been all along that this is going to be a weakening element in the picture through 1960. The interest rates, of course, were high. The result was that with the kind of ceilings on FHA and VA mortgages, and therefore with the discount at which these mortgages would have to be taken to make the yield rate on those instruments competitive with corporate bonds, it was expected that financing was going to be difficult, and that therefore residential construction was going to constitute a drag throughout 1960. Possibly we might lose as much as, say, 10 percent--a 10 percent reduction in the volume of the residential construction vis-a-vis 1959.

It must be said that December looks better than I think was the expectation. The volume of new starts actually increased. And even the VA appraisal requests and FHA commitments data look surprisingly strong. I want to comment further on this in a moment.

Now, so far as the other aspects of the consumer market are concerned, there was a good deal of optimism. We were hearing around the turn of the year about the possibility of a seven-million-car year; and the presumption was that consumers were going to be in a pretty optimistic frame of mind.

Some cross currents developed here, and have developed since. In the first place, in about mid January we had the results of the survey of consumer sentiment conducted by the Survey Research Center at the University of Michigan. This was released in mid January. And it must be said that it showed somewhat less buoyance in consumer sentiment than had been expected.

Consumers were surprisingly--well, just to take one of the numerous statistics--in a preceding survey 66 percent of consumers anticipated that business conditions a year ahead would be better than they were now. In the survey conducted by year end, this had declined a bit. So far as price expectations were concerned, there were again the same kinds of cross currents evident. The survey of the NICB, which was conducted a little after this, together with certain information that was picked up by the Survey Research Center itself, did indicate that some of this greater degree of caution on the part of consumers was apparently reflecting the unsettling effects of the steel strike. But whether it reflected more than that remains to be seen. In any event, the fact that a seven-million-car year now looks quite impossible--at least there is not much evidence yet of anything building up to a seven-million-car year--suggests that there may have been something a little more than just a transitory effect of the work stoppage in steel.

Now, if I were to put these figures together, I think they would come out something like this: that we might have, say, a plus 4 on inventory; a plus 5, say, on capital outlays; somewhere around a 4 to 5 in Government spending; well, give us a plus one so far as external trade is concerned; and then consumer spending up something like 18; and that, if my addition is correct here, makes about 32 billion. That brings our 478 billion GNP for 1959 up to 510 billion for 1960, if it's realized.

In the last few weeks I think it's quite obvious that there has been a much more cautious attitude developing so far as business prospects are concerned. A couple of observations are, I think, pertinent to this.

One of them is that we probably need a seasonal adjustment factor of business sentiment. As I recall it, looking back over the last several years, sentiment is apt to be seasonally very close to its low point somewhere around this time of the year. I don't know whether this is connected with the sort of decompressing effect of the post-Christmas period or the weather or what it is, but a wave of caution is very apt to sweep across the country somewhere around February actually.

The second comment I would make is that this more cautious sentiment is, I think, a wholly desirable thing in and of itself, because if the kind of exuberance had continued which was evident somewhere around the turn of the year, right after the settlement of the steel strike, then we could have had the kind of explosive upsurge in business activity which would almost have guaranteed difficulty later on, that is, difficulties of a fairly serious sort, a very destabilizing kind of thing. This greater degree of caution which has emerged may actually turn out to be the kind of thing which will help us to move forward on a somewhat more orderly and sustainable basis than would have been possible otherwise.

But now, there may be, of course, somewhat more to it than that. At least, this is a question that we have to raise. And we know, of course, that there are certain fragments of evidence that there may be more to it. One of the obvious things that we might cite is, of course, what has been happening to the stock market since the turn of the year. There is still the probability, it seems to me, that our price level may rise somewhat. And, moreover, there is a cultural lag phenomenon here that we need to bear in mind. That is that for a considerable period of time in the post-war period, even though our price level was tending to edge upward, there was a good deal of confidence on the part of consumers in the long-run stability of the price level.

One of the interesting things in the surveys that the University of Michigan has been conducting for twelve or fourteen years now is that even in those periods when a large percentage of consumers expected the price level to be higher a year from now than now, you ask them, "Well, what about the five-year period ahead?" and you would find quite a vote of confidence in the stability of the price level once you got beyond this hump here, so to speak.

Now, the interesting thing is that that confidence in the long-range stability of the price level has clearly been weakened; and in the last survey the percentage of those expecting the price level to be higher five years from now than it is now was just about as high as the percentage expecting it to be higher a year from now than it is now.

Secondly, the evidence is quite clear that the expectation of a rise in the price level has an inhibiting effect on consumer spending, not the other way around. The textbooks may argue that if people expect higher prices, they will buy now in order to avoid higher prices. The evidence from these surveys pretty clearly indicates that the thing works the other way around; that if people expect higher prices, they reason, I think, something like this: that this is no time to be going into debt, committing themselves, because their own income may not rise; and if they got into debt, they would be caught in a real bind. And so this greater degree of uneasiness about the price level may itself be a restraining factor in the consumer situation.

Now, I used the term "cultural lag" a moment ago because, if it is true, as there is some reason to think and as there is some expectation on the part of a great many people, that our price level problem may be becoming at least a little bit less intractable, we may have a cultural lag here where early in this postwar period, when the price level problem was in fact very far from being under control, there was a good deal of confidence in the price level; and now that we seem to be on the threshold of perhaps more nearly getting on top of this problem, we may now be bedeviled by the fact that for quite a while now consumers aren't going to believe it, and that that's going to have an inhibiting effect on the economic situation. Well, we have to be prepared for that at least.

A second possibility that there may be more to this is, of course, the possibility that we might have a financial bind. We certainly had very little monetary expansion in 1959. Commercial bank deposits actually from year end to year end increased almost none. There isn't any question but what we could not have this kind of 32-billion-dollar expansion in gross national product if again in 1960 we had no monetary expansion. However, thanks to a lesson which I had from the New York Times this morning just before coming in, there seems to be some evidence that possibly the Federal Reserve is not unaware of that also.

There is this to say also: We need to bear in mind that we have certain automatic compensating factors here. That is that if the demands in the capital and credit market result in somewhat easier conditions, which in a sense, you see, is reflecting a weakness in certain aspects of the economic situation, this then tends to produce a decline in interest rates, a firming of the bond prices; and the decline in interest rates in turn tends to have an activating effect on housing and to some extent on State and local financing. And so it isn't all bad, in other words. What produces this over here will tend to produce a plus over here. And this may be to some extent, if this is true--we may find that housing is going to be less of a drag, for example, in 1960 than we had expected.

Now, the final question is, of course, the one that has been raised a great deal; namely, What's the possibility of a down-turn in the second half? In other words, is 1960 going to be a peak year?

At this meeting about six weeks ago here, we took a vote to see how many expected better business in the first half. Practically everybody did. But with due recognition of the fact that rather persistently throughout the postwar period the votes that there might be a down-turn in the second half had been considerably larger than the vote for the first half year after year, economists this time, I think, exhibited somewhat more courage at least.-- whether they are correct or not remains to be seen--and a greater degree of expectation that this would continue through the year.

Now, I do recall a study which Joe Livingston, whose column you see in the Washington Post, made some years ago. He conducts a poll of his own. He would ask in this poll of economists, "What about business conditions six months from now?" Almost always up. Then the next six months, usually down. So you would get this dog-leg effect, you see, as business activity persistently went on up. But economists do learn, as well as others; and finally, in 1948, they saw the light; and so they predicted an expansion right through the year. That happened to be, however, the period of the first decline; and this may be another one.

Let me just say that the possibility of this second half decline is obviously one that we mustn't rule out. If the inventory build-up should be over a little sooner than I had expected six months ago--and there is some slight evidence that it might be-- that will be a minus element. Certainly the auto market, as I have pointed out, has been somewhat disappointing. We do know that the earlier estimates of the trend in capital outlays have been lowered somewhat. They haven't been reduced, but they have shown reduced rates of increase. I think myself that's largely associated with the disruptions incident to the steel strike.

My own feeling is that we've still got a considerably better than even chance of this expansion to continue through 1960, with something like a 510 billion dollar gross national product, as indicated in the budget message, still a possibility, still as good an estimate as one can make, largely because if and as business activity continues to expand, capital outlays ought to start to become an even more supporting factor as more nearly throughout the economy we get pressures on capacity.

On the other hand, obviously, with an expansion now moving into its third year, as it will beginning in April, we are reaching the kind of critical stage where once again the problems of economic policy become very much more difficult, with decisions having to be based on a much closer balancing of factors than is necessary, for example, in the early stages of an upturn, when you know that the next quarter is going to be better or the next several months; or even the early stages of a downturn, when you know that for some time to come the news is going to be bad and you can orient policy accordingly. Now we are going to be once again in this kind of period when the policy maker, so to speak, if he ever does, is going to earn his salary.

Well, I think any comments for the longer range we might reserve for the question period.

COL. SMYSER; Dr. McCracken is ready for your questions.

QUESTION: Would you give your views on the longer-range outlook?

DR. McCRACKEN: I spent a whole semester on this in a seminar at this last semester. But this isn't disturbing. I think I can cover that in five minutes or so. That's a very good question; and, of course, it's a question that is right at the focus of what could justifiably be called a great debate, so to speak, at the present time.

I would merely make these observations: that, first of all, with all due respect to Kenneth Galbraith and what is undoubtedly one of the most provocative and witty books on economics--at least we have one economist who can write and get a book on the best-seller list--nonetheless, we do need growth, not necessarily and not only because we don't want the Russians to catch up with us, but because we are not yet a very affluent society. There is a tendency, I think, to be excessively mesmerized by a 500 billion dollar figure, not recognizing that the average family income in the United States is still only about a hundred dollars a week; and you don't live at a level of great affluence at a hundred dollars a week.

The second point that I would make is that I think entirely too much of this current discussion about growth is directed toward the easy question to answer. That is, the authors too often set for themselves the easy question, namely, Do we want more growth? Well, of course we do. Nobody is going to argue about that, for obvious reasons. I would cite as an illustration the kind of article, for example, that Burley wrote in the New York Times Magazine last Sunday.

Now, the hard questions, and the questions that economists ought to be directing themselves to, are, What are the economic policy decisions that the country has to make and face up to if we are going to achieve a more rapid rate of growth? Otherwise growth becomes a kind of pie in the sky and a numbers game, to to speak, not directed toward the questions that we've got to find answers to if we are going to achieve this kind of thing.

Now, what are some of these questions? I think one of the questions is, in fact the overriding question is, What does produce economic growth? And I would submit that we know very little about the answer to that question.

It's, of course, pointed out that more machines, more capital, makes for a more productive labor force. And, obviously, it does. We certainly know that a man equipped with a bull dozer can move more dirt than a man equipped with a spade. But one of the things that recent economic research makes quite clear is that there is a heck of a lot more to the problem than that. Solomon Fabricant, of the National Bureau, in a study that I think is a very interesting one, points out that over the last 60 or 70 years, aggregate output has increased at the rate of ~~about~~ something like 3.5 percent per year; and about 1.7, or in other words, about half of that growth can be explained by the increase in labor and capital combined.

Now, this, it seems to me, suggests the conclusion that we don't seem to know very much about what explains the other half of this rate of growth; and that, until we do, until we know what will do it, we can't be very sure that we would know how to achieve a goal of, say, 5 or 6 percent growth instead of what we have been doing.

Now, there are certain things, however, that, it seems to me, we know. We know that even if capital formation is not a sufficient condition, at least it's a necessary condition. Obviously this suggests the desirability that we ought to do in our economy whatever we can do by way of making capital formation proceed more rapidly.

Here it seems to me that many of those who are talking the most eloquently about growth are also advocating the kinds of policies which will make growth more difficult to achieve, because, let's just face it, if we need a higher rate of capital formation, we need a higher rate of saving. We need to make sure that capital goes into in the economic sense productive uses. This might even mean less housing, if we might cite one sacred cow here. It may very well mean something so far as, say, corporate income taxation is concerned. There are a lot of possibilities in the direction of, say, a lower rate of corporate income taxation, or more generous depreciation allowances. We can think of several possibilities. I don't think any of these would be on the list of those who are more articulate at the present time about so-called growth.

Now, thirdly, it obviously is clear that we've got to take cognizance of the various things in our society that may be inhibiting the optimum use of our labor and other productive resources. I would be the first to concede that, for example, featherbedding is not the only problem in this connection that we face; or, in any event, that there is featherbedding in other places than the assembly line. We certainly have it in universities. I can think of some people on our staff that aren't making a dollar's worth of contribution to our university. I suspect it probably happens in the Armed Forces. I suspect it happens in business. I suspect it happens in Government. I doubt if it's very much more pervasive in one place than another.

But the thing that we do have to face is that we also have to face up to the possibility that we can't at one and the same time talk about the need for growing more rapidly and also support policies which in effect hold down the productivity of our work force. We can't talk out of both sides of our mouth.

Now, finally, I would make the point also myself that while there has been some greater degree of optimism about the price level problem, I think we've got to recognize that we're still not out of the woods on this problem; and I'd make just this observation:

I would again agree that this price level problem is another one of these multi-dimensional problems. But one thing, it seems to me, is quite clear: that the aspect of this problem which we are still the farthest away from solving is the wage-cost problem. This in spite of the vast amount of evidence that has been turned up, for example, in the Joint Economic Committee's five-foot shelf of books which came out in the last year, much of this material being quite illuminating and quite excellent. And once again here I see very little disposition on the part particularly of those who are, as I say, most articulate about growth, to face up to this problem.

Now, if we don't, then we do have to face the fact that we still have an economy where the internal pressures are such that putting it under any kind of forced draft in terms of easier monetary and credit policy and fiscal policy, it still is an economy where too much of the response is apt to be in the form of a higher wage-cost-price level, and too little of the response is in the form of increased output. And until we can readjust these internal factors in our economy so that there is greater internal resistance to these upward pressures, then, it seems to me, it would just be irresponsible public policy to insist on easy money and the other things that will put the economy into forced draft and, I am sure, give us the kind of spurt that could not possibly be sustained on any on-going basis.

I think that that committee report, and the Joint Economic Committee's report itself, are justifiably to be criticized. On this one aspect and on all the other aspects which are also relevant to the problem, they had a great deal to say and many suggestions, and many of the suggestions are good. But of the 488-page staff report, 9 pages are devoted to market power problems; and here, of course, we have several suggestions for anti-trust amendments, most of which are good. Then we come to the market power ~~power~~ problem in the wage area; and one has the feeling that all at once the author had bitten into a sour pickle, and so he did a toe dance on eggs and went on to monetary policy and so forth, which is much safer to talk about.

Now, unless we have the guts to face up to this problem, then I submit we still are dealing ourselves the easy questions to answer, not the hard and relevant ones on the question of growth.

QUESTION: Sir, in your discussion of the prospects for 1960 you related the statistics back to 1955 in some of the cases in order to project what is going to happen in 1960. Would you care go go back to '57 and '58 and see if those same types of statistics are going to occur in 1962 and 1963 based on the same set of figures?

DR. McCRACKEN: Yes. Well, I think that's a very good question. In some cases I went back to 1955 only. In the case of capital appropriations, for example, it's because the data go back only that far. But I think you've put your finger on the key question to ask about the short run, and that is the possibility that we may have a recurrence of the same kind of concatination of developments that we had in '57, which gave us our downturn in '57 and '58.

Now, it seems to me in a nutsell that what happened there was-- and it's related to what I was talking about a moment ago--that we had throughout that period--1955 and '6 and '7--about the right kind of an increase in so-called aggregate money demand for output. In other words, aggregate expenditures on output in dollar terms were rising at the rate of about

5 percent per year during that period. Our economy certainly was not growing any more rapidly than that.

The problem was that prices were rising during that period such that they were absorbing half to two-thirds of that 5 percent; and that meant that in real terms this 5 percent more spending was buying, say, only 1 or 2 percent more per year in output. And the result was that we were getting, of course, growing excess capacity; and growing excess capacity almost assures that sooner or later your capital outlays are going to start to weaken.

Now, the question is, of course, Why did prices rise? Well, that's, of course, a very complex problem; and it has been pointed out that there are all kinds of dimensions to that. We had substantial shifts in the pattern of demand, which is correct. We did. And a substantial part of the price rise came in machinery and hard goods lines, which was true. And since prices go up a little more easily than they go down, if you get large increases in one area, then the average price level goes up.

But once again here I would submit that one of the key problems here was that throughout this period we had these irresistible pressures on wage rates, which were causing a rise in our unit cost level. There were other aspects of cost going up also--no question about that--but let's focus our attention on the most intractable problem instead of the easiest problem all the time, because otherwise we'll never get very far. During this period what fundamentally was happening was that our unit cost level was rising more rapidly than our price level. Or, to put it the other way around, it is true that businesses were raising their prices during this period; but on balance they raised their prices less than their costs were going up, and the result was that their profit margins were declining. Corporate profits in the aggregate were lower in '56 than in '55, and lower in '57 than in '56. And corporate profits per unit of output, of course, obviously were going down throughout that period.

And so we got this emergence of excess capacity and squeeze on profit margins, both of which were adverse to the durable goods lines. Capital outlays started to level out. This kicked back on the inventories, particularly in the hard goods lines. We got a reversal from inventory accumulation to liquidation. We did get an air pocket in defense orders in the third quarter, which contributed to this problem. And this in a nutshell, it seems to me, was the 57-58 downturn.

Now, the question is, Are we going to get the same kind of sequence of events shaping up here? I think to some extent we are.

What, it seems to me, we have learned and what this story in the New York Times may imply in regard to monetary policy is that it is desirable in the fairly early stages of an expansion to have a fairly tight rein on credit; so that you don't start fueling the kind of explosive expansion that you can't possibly sustain.

Now, this was a mistake which the Federal Reserve probably made in 1955. They let too much oil get poured out on the fire here, and then they had a conflagration on their hands which they had difficulty controlling later. This time they didn't make this mistake. They turned around pretty quickly in 1958 after it was clear that the upturn was started.

But then it seems to me the second lesson--and this I think was a mistake which the Federal Reserve made in 1957; and I might add that I thought so at the time--was that they didn't see that as you move into the second half, so to speak, of the expansion, or at least what then were the latter stages, then it's desirable to start easing up, because then, if you don't, you are going to apply the brakes so hard that we'll get a downturn.

QUESTION: You indicated that there was an unexpected caution developing among consumers which might affect the GNP growth during 1960. I noticed that during your talk you have meticulously avoided any mention of politics. I wonder how much of this caution could be attributed to the economic question that is being inserted into this political campaign that is coming up.

DR. MCCRACKEN: I really don't know. To take the Survey Research Center's survey, the elements that seem to come out of the survey which indicated a somewhat cautionary note were, first of all, the steel strike. The steel strike was still exerting an overhang effect, so to speak, at that stage. A lot of people directly had lost income. A lot of people hadn't lost income but their neighbors had, and that made them a little nervous and so forth.

Secondly, there was this price level ~~thing~~ change which showed up fairly clearly.

Third--and this is something which is not to be repeated, of course--

it was clear from this survey that while the compact cars were creating quite a stir in public thinking, the regular-sized cars were being greeted on sort of a "Ho hum" basis. They didn't really create much excitement. This is important, because the volatile element in consumer spending is durable goods, and about half the durable goods expenditures are normally on automobiles.

As to the extent to which the political thing may be injected there, it didn't show up too much, as I recall it, in the explicit surveys. But, of course, one never knows to what extent that is the kind of thing that is operating in the shadows behind the statistics, so to speak.

QUESTION: Dr. McCracken, I hope this is not an unfair question to ask a man from Michigan, but currently we're spending about 15 billion a year for education, and the Rockefeller Fund is projected at least to be spending double that amount in about five or ten years from now. Do you feel in your judgment that State and local governments actually have the financial capacity, that is, the majority of them, to finance such increased expenditures for purposes like education?

DR. McCRACKEN: Well, I don't know whether they have the capacity to finance that. I think they have a capacity to finance a great deal more than perhaps we think they do.

A part of the problem here has to do with getting the kind of State and local tax structure which will be conducive to this sort of thing. I think the fiscal impasse which the State of Michigan has been in for the past year or so rather illustrates this point.

The fact of the matter is, I think, that the fiscal impasse in Michigan has not been generally understood either in Michigan or outside. The problem really comes down to what is in the nature of a great debate over the nature of the tax system that the State ought to have, and an inability of the two sides to get together on this. While Michigan does have some excess unemployment, it is still a high income area. In other words, the problem is not arising, in the first instance at least, out of the fact that it's such a depressed area, so to speak.

Now, I think we've got to face up to this; and a lot of businessmen, it seems to me, don't see this properly. First of all, we've got to get rid of this illusion that if we can squeeze out waste and inefficiency out of the government budget, be it Federal, State, or local, we could undoubtedly cut taxes enormously. There is this illusion, you see, that if you could just get rid of the stenographers who are throwing spitballs at each other and so forth and so on, think of all the billions and billions that you could save, without ever looking at the facts to see whether they support it.

Now, I was interested that in a meeting that I attended and that I participated in, where Governor Williams and Senator Beetle, who is alleged to be the leader of the more, if I may use the term again, troglo-ditic wing of the Republican party, at least both agreed on this--and this was an audience of businessmen: Just get rid of the idea, get rid of the illusion, that there's any way to cut the State budget by squeezing out waste and inefficiency. Cutting the State budget means cutting programs.

They both agreed on that.

Now, where they disagreed was on the kind of tax system we need. In my view we have gone too far in this area in assuming that a tax system is a good system in the sense to which it produces an more equal distribution of income; and we have not gone far enough in asking the question: What kind of a tax system for a State is going to be least repressive so far as its economic base is concerned? And that's a question which at least the State of Michigan cannot afford not to ask, because we do not have an industrial base large enough to provide full employment for the labor force.

Let me only say this--and I would defend this as not being an illiberal position. I think it's a liberal position, because it will make a contribution toward providing jobs in Michigan--that is that we need to talk less about taxes on corporate income and even income taxes, and that something more like, say, a sales or excise tax would contribute more to the welfare of the laboring man in Michigan, certainly to the unemployed one. And this is the issue that hasn't yet gotten resolved, with one group wanting a so-called "equitable" tax structure, which means taking from the high-income people and not from the low incomes; and others who feel that what we need is a tax structure that will raise the revenue, but will have less of an inhibiting effect on industrial and economic development. In my view, we have to give more weight to the latter than we have been giving. And if we do, we can at least do more than we can if we don't face up to it.

COL. SMYSER: Dr. McCracken, I wish we had more time for many the/other questions that we have, but, unfortunately, our time has expired. I do want to thank you for what I am sure we all agree is a very fine talk. Thank you.

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