ECONOMIC INDICATORS

Professor Martin R. Gainsbrugh

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Reviewed by: Tom W. Sills, Colonel, USA

Date: 12 October 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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GEN. MUNDY: One of the additional duties assigned to the Commandant of this institution is that of being the official Department of Defense liaison representative to the National Industrial Conference Board. I'm sure that most of you have heard of this distinguished group, for in my opinion they are the honor roll of American business, and doing a very good job for this country.

We are fortunate today to have as our speaker their Chief Economist, Professor Martin R. Gainsbrugh, who will talk to us on the subject of Economic Indicators. This is a very natural follow-up, a very logical follow-up to the lecture that you had last Friday on the subject of national accounting systems as modern-day necessities in our economic life today.

Now, although this is Professor Gainsbrugh's seventh lecture at the College, this is his first appearance on this platform, naturally, this being a new building. He has indicated in other ways than just coming here frequently as a lecturer his friendship and interest in the College. He has been a member of the Board of Advisers of the College during my incumbency as Commandant.

Professor Gainsbrugh, it's a pleasure and a privilege to welcome you to this platform for your seventh lecture.

PROF. GAINSBRUGH: Thank you, General.

It's a delight to see one forecast at least--because this was no more than a forecast seven or ten years ago--take practical and physical form.

I am still overcome with the reality of the College, having seen it initially only in talk form and then in paper form. As I said to the General this morning, I have only one small element of concern now that I have seen the College, and that is that after you have left the ivy-covered halls, how can we keep you in the style to which you've grown accustomed?

I'm going to talk with you about the same topic to which I have devoted such comments as I have with this student body over the past seven years. Despite the label that may have been given to this particular talk, my assignment, as I regard it, is to discuss with you the current business outlook. And this is perhaps the most hazardous pursuit of my profession. But I regard economists as expendable.

This is budget-making time for American industry. This is the time in which they are deciding whether to continue their investment expansion program for 1961, or whether in the light of the growing uncertainties of the past six or eight weeks, to start cutting back on some of their expansion programs. And they need all the help they can get from the business analyst and the business economist.

So I want to review with you our current economic situation, using one of the best tools that the economist has thus far devised, not only for the policy makers in Washington, but also for the businessman--using economic indicators, the latest edition of economic indicators--August, 1960. You make certain that you have that, and a pen or pencil handy so we can quote some later figures from those that are in the economic indicators.

We have the best system of economic intelligence of any nation in the world. We already have at our command not only the figures for June and July, but also for August; and in some instances we can begin to speculate productively about the indicators for the third quarter and for the month of September. So you will need that, economic indicators, pen or pencil; and 20-20 vision helps too.

Let me tell you a bit about this document while you're ferreting it out. This "Economic Indicators" was begun by the Council of Economic Advisers to be of assistance to its own staff, to the members of the Council, in determining the current position of the economy. They started assembling pertinent bodies of data and charting them.

In discussing the national economy with the President, they very frequently brought along these data and charts, and it wasn't too long before the President was being supplied and the Executive Office was being supplied this material on a regular monthly basis. Members of Congress heard of it next and asked that copies be placed at their disposal. Then, having seen the document, they were convinced that it ought to become a public document; and subscriptions to it have been rising steadily ever since. It's the best buy that I know of in the field of economics for two dollars per year, perhaps one of our best inflation hedges.

Let's start at the very beginning, if you will, by looking at the table of contents and seeing how well geared this document is to answer the three questions involved in the outlook. I commend all three questions to you in your current appraisal of where our national economy stands as we move into the fall of 1960.

The first question involved in the outlook is, Where are we? Just exactly where are we in terms of the business cycle as best that can be determined? It's not unusual for economists to differ about where the economy may be going. It is unusual to have as much conflict within our fraternity as we have at the moment about where we are. The first question involved in the outlook-- it's not always to find an answer to it--is, Where are we, on the basis of the best factual evidence available? That determination of current position grows even more difficult in a year divisible by four. The first question, then, is, Where are we?

The second question involved in the outlook is, How did we get where we are? What are the forces which have brought us to our current position? What are the expansionary forces, what are the contraction forces, at work? Where are we? How did we get where we are?

Then, and only then, it is my contention, are you in a position to deal with the third question: Where do we go from here?

Let's explore all three questions in the time at our disposal this morning. Where are we? How did we get where we are? Much of the answers to those two questions applies to the third question--Where do we go from here?

Now, turning to the table of contents: The table of contents is set up so that it throws light on all three of those questions. For instance, I want to discuss with you, first, some of the best measures available for the determination of current position. I suggest that you label these as thermometers. And we will look at these temperature readings as of September, 1960. Among the best thermometers that my fraternity has been able to devise thus far are the following:

No. 1, first and foremost, page 2, gross national product, about which you have been hearing from Paul McCracken, for example. That's on page 2 and we'll turn to it a little later. At the moment I want to indicate the major thermometers shown in the table of contents, and move from that to the major barometers. One of the major thermometers, then, is the output of the USA, the total output of the USA, as reflected by our gross national product.

The second thermometer, not to be overlooked in the light of the emphasis upon the bad news recently, is sources of personal income, our personal income figures. Those are shown on page 4. That's the second thermometer.

The third thermometer--determinant of current position--employment and unemployment, status of the labor force, page 11. That's thermometer 3.

The fourth thermometer--the index of industrial production--the physical output of the nation's factories and mines. That's already available for the month of August.

The fifth and sixth thermometers, the price thermometers. Pages 23 and 24. The consumer price index and the wholesale price index.

Those are some of the measures that we will be looking at in trying to get a fix of our current position. You will be interested in those.

You will be even more interested in such tools as we have thus far been able to devise that have barometric value, as distinct from the determinant of current position. And included in these economic indicators are several such barometers; and, if time permits, we'll look at the barometers as well as the thermometers.

Among the barometers that I suggest you follow intensively in the course of the next few months are these: corporate profits--a highly sensitive series. That's on page 8. Expenditures for new plant and equipment, page 10--another important barometer. Pages 19 and 20, the construction series, particularly the award series. Housing starts today are housing expenditures three or six months from today. Heavy engineering awards today begin to reflect the probable level of construction activity six, nine months from today. They have barometric value--housing starts and new construction.

Perhaps one of the most widely followed barometers in business circles--new orders, as they are contained in page 21 in this series labeled "Sales and inventories." New orders. If there's anything disturbing most of the men in industry as they make up their plans for 1961, it is the fact that order books throughout 1960 have not come up to their expectations. So this series has high barometric value.

And, lastly, some of you have been anticipating another barometric series that seems to be of interest to this audiences year after year--industrial stock prices, on page 30.

These, then, are some of the measures that are reported on month by month in this particular document, that are frequently released in this document well before they are made available elsewhere.

Let's start first with some comments, then, on our current position. And here I want to begin with page 16--a measure that perhaps is not as familiar to you as it should be--the index of industrial production. This is the measure that I most frequently comment on initially in my own appraisal of the this thing before business audiences--the index of industrial production, as presented on page 16.

This measure presents in one single figure the trend in the physical output--and that is the key word to keep in mind in connection with this measure--the physical output of the nation's factories and mines. You look at page 16 and you will see in the first column the figure for the month of July 109, which, for the benefit of the uninitiated, means that the physical output of the nation's factories and mines in the month of July, page 16, was 9 percent higher than in the base period, 1957. You may want to jot down the other figure released for August--108.

If you look at that series for the calendar year 1960, you will see there signs of retardation. Physical output was at its height in the months of January and February. It held at a plateau in the months thereafter, seemed to break up in the month of May; and then it's been coasting a bit downward in more recent weeks.

For such perspective as it may give you, look toward the top of the page and see the graph of this particular measure -- the index of industrial production. Note where the trough was reached in '57 and '58--the recession.

The low point was reached in April of 1958. You observe the trend of that line upward until mid 1959, then the interruption by the steel strike; then the resumption, which started in 1960, of high activity; and then some degree of retardation. thereafter.

This measure has been seized upon by some of my colleagues in some instances as an indication that contraction and recession began as early as May of 1960. One eminent economist has already singled that period out as the turning point in the business cycle. Some others would have the turning point back as early as late 1959.

May I suggest in connection with such conclusions that the primary reason for the high figures reached in January and February was the build-up of steel inventories after the steel strike; and that the retardation at present in this index from March through July may be more a manifestation of a return to sustainable levels of production, in which production is geared to consumption, rather than to the unsustainably high levels of production in January and February, when production was geared not only to consumption, but to the catching-up process in the steel industry so far as steel inventories are concerned. But there is evidence here, nevertheless, of retardation as we move into the fall of 1960 so far as the nation's factories and mines are concerned.

That's the first measure of current position--high-level activity, but loss of momentum. This, however, is only one of the thermometers.

The second one I'd like to explore with you is on page 2--the gross national product; and by this time you're expert in concept and measurement;so that I don't have to waste time on such simple things; but can deal with matters of substance rather than of form.

This is, in my judgment, the single most important economic statistic in our society. Increasingly, not only those in government, but those in business, as well as the lay public, interpret this figure as the most significant, meaningful figure relative to aggregate economic changes. And there, for such comfort as it may be to you, notice first the quarterly rate of growth in national output on page 2, the second column--"Total gross national product." It shows that, even in the disappointing second quarter the dollar value of the nation's output of goods and services was higher than in the first quarter. It continued at peak level. And, in my judgment, when the figures are released for the third quarter--and enough of the third quarter has elapsed so that we have a pretty good fix on the third quarter--the total output of the USA, despite the cutback that has gone on in the factory area, will be at least as high as it was in the second quarter. You can therefore post that in about a month the figure for the third quarter, the gross national product, 505, will have gone at least as high as the second quarter.

This is significant in and of itself, but let me underscore its significance in a different way. One of the reasons for the high level of activity in the first quarter, and again in the second quarter, was the build-up of inventory. And we can look at gross national product, after excluding inventory change. When we do that, we're looking at what is called final demand or final product use--the goods that are taken off the marketplace for other than inventory purposes. And this becomes a very revealing line of analysis as we move into fall of 1960.

On page 2 you may want to note this simple bit of arithmetic: In the first quarter of 1960 we produced goods at an annual rate of 501.3. Are you all with me? The second column, total output of the USA, quarterly output at an annual rate. Of that, 11.4 billion went into inventories. We were building up inventories at an unsustainably high rate in the first quarter. If you subtract from 501.3 billion in the first quarter rate of annual output the 11.4 billion that went into inventory, you will have, then, final product demand for purposes other than inventory, of 489.9. One of the reasons for the high level of activity in the first quarter was the excessively high build-up of inventories. Normally we build up inventories at perhaps a 3-billion or 4-billion annual rate. In the first quarter we were building them up at three times the normal rate. It was to be anticipated that this rate of inventory accumulation would not go on, could not go on.

Now, in the second quarter we turn out goods at an annual rate of 505 billion dollars. Of that, 5.3 billion went into inventories. We cut back on the rate of inventory accumulation, but inventory accumulation was still going on, perhaps excessively so in some industries. In the second quarter, then, of 1960, end product demand, GNP, minus the inventory build-up, comes to 499.7 billion dollars. Note the increase in demand for other than inventory purposes in the second quarter.

Now, in the third quarter--and one of the reasons for the uncertainty prevailing as we enter fall--inventory demand falls off to zero; or inventory liquidation may actually have begun. We're not quite certain as to the final dimensions. But what happens in the third quarter, then, is that we turn out 505 billion dollars worth of goods. The inventory change is zero at best. The end product demand--goods taken off the marketplace--is 505 billion. Despite our complaints about the levels of activity in the third quarter, as in the first and second quarters, the demand by consumers, by business, by government, and by foreign economies, in the aggregate, is greater than ever before.

So I give you, then, a second characteristic of our economy as we enter fall of 1960. The first characteristic--signs of retardation--particularly in the factory area. And the second characteristic is continuing strength of end product demand, as evidenced by the phenomena with which you are familiar.

Well, let's get a quick look at a little more of these. Page 4, "Personal income." Why is demand staying at as high a level as it is in the face of the uncertainty and the dislocation that we continue to read about? One reason is to be found on page 4. The high levels of personal income--it's a simple rule of thumb--give people more income than they have had previously, and they would either spend it or save it. And the rising levels of personal income in 1960 have been accompanied by rising levels of consumption--not necessarily for factory-made products, not necessarily in department stores. More and more for the service sectors of the economy--for culture, for recreation, for touring, for travel, for baby sitting, for pari mutuel betting, for old-age insurance, for medical care--more and more in the service sector, and less and less in the factory area.

In my judgment, one of the most significant trends of the 1960's may very well be some subsiding in the relative importance of manufacturing, as compared with the overemphasis upon manufacturing from the onset of World War II through the 1950's. We are changing the character of our product mix. That is affecting the degree of activity in manufacturing, and it's affecting the composition of our employment picture. Manufacturing and mining are no longer as important in our national economy as they have been in the past.

The August figure, which you may wish to post, on page 4--high levels of personal income--407.6. You'll note that in the second quarter of 1960, personal income was around 404 billion dollars. In the third quarter it will have moved up to around 407 billions of dollars or 408 billions of dollars. A continuing rise in personal income. Losses in the manufacturing sector in terms of employment, offset by gains in employment in the non-manufacturing area. And that leads me to the next measure, on page 11, the employment figures.

There you may want to post again the figures for August as they have been released. Are you all with me? We are now up to the thermometer shown on page 11 --the employment figures. There the figure most recently released for August is 68.3 million. You will note that that's in the third column. It should be posted below the figure "Civilian employment"--it should be posted below the figure 68.7, million employed in the month of July. Some decline in the levels of employment. And this was seized upon, again, by members of the jitterbecks as further confirmation of the turning point in the business cycle.

But look with me, if you will, at the composition of the employment and notice where the change came. It came more in the agricultural area than in the non-agricultural area. The figure for agriculture, 6.5 million--the onset of seasonal decline. Non-agricultural employment 61.8 million, where it had been in the month of July. Substantially higher than it had been in past Augusts, including August, 1957, when the economy was still at peak level.

Well, we were wondering why end product demand stayed as high as it did. That came as a surprise to many of you. We found that the reason for it was high personal income in good part. Then you wondered about the reason for high personal income, and we found that behind it was the high levels of employment shown on page 11.

At your leisure explore page 12 for what I said about the changing character of the employment in the USA, and the confusion that may exist between this secular change, this long-term change, in the composition of employment, as distinct from a cyclical change. Page 12. Look at it a minute--manufacturing employment. Had you realized this? In 1953 how many people were employed in manufacturing? There were 17 1/4 million. That was a year of high activity. In 1957, another peak year of operation, how many people were employed in manufacturing? A half million fewer than in 1953. And in 1960, 16.4 million, the August figure--another high-level period of activity--but the employment in manufacturing shrinking.

But don't assume from that that contraction goes on elsewhere in the economy. Look at the rise in private non-manufacturing in the same period of time. Or need I direct your attention to the last column--the rise in government, the employment in government--6.6 million in '53, 7.6 million in '57, and 8.4 million in 1960. Another form of service operation. Income nevertheless derived from this particular pursuit.

High-level employment, and then on page 15 at the highest wage rates, the highest weekly pay checks, in our society. Pages 14 and 15. The era of the hundred-dollar pay check, average one hundred-dollar pay check, began in 1960.

Look at durable goods manufacturing and you will see that at the start of the year it had crossed the hundred-dollar mark, and even in the doldrums of July was holding pretty close to the hundred-dollar level. And not just in the steel industry or the automotive industry, but increasingly in other sectors--electric machinery, petroleum, printing and publishing--more and more such industries.

And by way of providing you with perspective, the comparable figure back in 1939, gentlemen, when I first joined the Conference Board--and the figure has stayed in my mind ever since--was $23.86. That was the size of the average weekly pay check two decades ago. Not generations ago, but in 1939, $23.80. Moving into the hundred-dollar range today. As shown on page 14, we used to pay 63 cents an hour for a combination of the skilled, the unskilled, and the semi-skilled back in 1939. Today the average wage rate is $2.3.80.

High levels of employment at high wage rates, yielding the high personal income. And strength of end product demand, representing basically the recurrent demand of the American people as they grow in number at the higher levels of income. But a highly dynamic, shifting, volatile consumption picture, that can leave the durable goods industries, in the case of the automobile industry in 1958, without types of demand to which they have grown accustomed, until they stop doing business with the same old models, the same old things. And the year 1960 has left many of the electrical appliance industries in exactly the same position, until they too start adapting their products and their prices to meet with the shifting character of this demand.

With that I reluctantly leave the area of thermometers and start exploring with you the area of barometers. But let me recap for you, if I may, the current position, as it was indicated by this series of thermometers. The year 1960 will go down in the books, unless something completely unexpected happens in the fourth quarter, as one of the best years in terms of GNP or industrial activity that we have thus far experienced. But as we move toward the close of 1960, there are signs of retardation becoming more and more apparent, particularly in the major manufacturing areas.

Some of these signs of retardation stem from deep-seated secular, long-term changes that are the consequences of World War II and the Korean War. The imbalances introduced by World War II and Korea are slowly being worked out in our system. The volatility of consumption is being increased. The pressures being placed upon the manufacturing industries in World War II and Korea and in the post-Korean early defense period are being relieved. Internal composition of employment and production is being altered. Many of these changes, therefore, are not signs of cyclical weakness. They are more signs of a change in the product mix in the year 1960 and throughout the decade of the 1960's.

Let's shift, however from the where we are to where we may be going approach, using the barometers that are placed at our command in this particular document; and you will begin to see why the problems of business planning have grown a little bit more compounded or difficult in September than they were in June or early 1960.

One of the most sensitive barometers that we have is contained in page 13--"Hours of work." When a businessman grows uncertain about his future course of operation, when his backlog of orders begins to shrink or is no longer rising, he begins to examine the desirability of paying premium time for factory skills. And if you will look at page 13, you will notice that in July the hours of work were slightly lower than they had been in June; and in the month of August the figure just released is 39.7. And in the durable goods area it's 39.8, as compared with the 40.1 or 40.4 prevailing in the previous months. And this, then, is one of the barometers which throughout 1960 has been tilted slightly downward, and which in the month of August moved down another notch. One of the highly regarded methods of indicating, not made for good reading, thus far in 1960.

But, lest you place too much emphasis upon that particular figure, 39.7 hours average work week still means that there is plenty of overtime in many sectors of manufacturing as we move into fall of 1960. On a nominal 40-hour work week you would average about 38 1/2 hours. That's the average work week on a nominal 40-hour basis, because of part-time illness et cetera. And we have still an hour at least above the 38 1/2 level. Nevertheless, it is one barometer that suggests that we are close to, if not in, the turning point in the business cycle.

Very quickly to review the remainder of the barometers before we break for coffee and the subsequent discussion period. Pages 19 and 20, the construction series, if you will look at that, particularly the contract awards. Some downward tilt on page 19 to the heavy construction award figures in the second to the last column for the 48 States. Page 20, the housing start figures. Compare the level of housing starts in June of 1960 with the level prevailing in 1959; and, as the Council reports, they are markedly lower, some 15 or 20 percent lower, than they were a year ago. And then in the month of July--I don't have the exact figure--about a million two--they were again lower than they had been in the month of June. Still another barometric series that has not been performing as well as a year ago or at the beginning of this year.

One that is particularly disturbing, because we helped to create this series, and hence must give more attention to its findings perhaps than to some of the others out of parental pride, page 10--"Expenditures for new plant and equipment," as well as "Anticipation of further expenditures." One of the areas of strength of demand throughout 1960 thus far, as you can see, has been the expenditures by industry for new plant and equipment. Notice that in the first quarter the outlays were sharply higher than they had been in the fourth quarter; that they continued upward in the second quarter; and it was anticipated that they would move upward again in the second half of 1960. Since this document was released, the figures have been revised and later expectional data have been assembled. You may want to ponder the new figures for their barometric significance. The first quarter total remains as you have it--35.15. The second quarter, instead of being 37.0, as was anticipated, was cut to 36.3.

The third quarter expectations, which were put at 37.5 three months ago, have now been reduced to 36.9. The uncertainties to which I have referred earlier of the second quarter, and some degree of experience with the third quarter, have led many industries now to reconsider, to start reconsidering, their investment program for 1961. This particular month, September, is budget-making period in many of our major industries.

From the conversations I had with men in key posts--they have been looking twice, if not three times, at the new order book for August and September, and they have been more than disturbed--some of them have grown concerned--about the fact that the new order situation has not improved in September, at least thus far. And so, as a result, they are beginning now to re-examine their capital budget for the year 1961.

Some of you know our own contribution--if not, you should know it imtimately--in this particular area--capital appropriations of the thousand largest manufacturing corporations. With the aid of "Newsweek" we report from quarter to quarter on the appropriations that have been made by the nation's largest manufacturing enterprises, the thousand largest. We figuratively plant a microphone in the board of directors' room of the U.S. Steel Corporation, General Motors, Standard Oil of New Jersey, and listen to what they decide to do in the way of investment in new plant and equipment. And, as we reported just about ten days ago, in the second quarter of 1960 the capital appropriations for the months ahead were lower by some 10 percent than they were in the corresponding second quarter of 1959. And capital appropriations today reflect investment in new plant and equipment 9, 12, and 15 months hence. There's a long lead time betwen the appropriations process and the subsequent patterns of expenditure.

So here, then, is another barometer, one with a substantial degree of lead time, that suggests that we had better become aware of the changes in the economic climate, and do what we can, via fiscal policy, monetary policy, and other similar approaches, to prolong this particular phase of prosperity or expansion in which we still find ourselves.

Two other barometers that I think I can at least squeeze in before adjournment time are these: Page 21, the new order situation, to which I have referred earlier; page 21, "Manufacturing new orders." If you were a businessman, particularly in manufacturing, this perhaps is the most important measure you would define. As orders build up on your order books, they become your woodpile upon which you will be working in the subsequent months. Notice the general characteristic of the new order series throughout 1960. It has been virtually stable at best. Some downward tilt began in the month of June. The July figure, 29.4--off from the June figure.

And lastly, for reasons of time, but also a good one with which to close, page 30--"Stock prices." There all I need do is refer you to the heavy black line at the top of the page. Notice the irregular but consistently downward tilt of this particular measure, again, with high barometric value, and the further downward course in the last few weeks.

If I may, I'd like now to close the book on the disappointing readings in the barometers or in such other measures as are related to the prospective scene. I'll get around to the elements of strength in the discussion period, but I do want to alert you, if you are not already aware, to the increasing degree to which businessmen have grown concerned about the outlook. (1) the disappointing new order situation; (2) equity markets and downward tilts; (3) the decline in construction awards; (4) the age of this expansion program. I told you it began in April, 1958. It is now around 28 months old. As business cycles go, this one is maturing. Still another, the high unemployment rate, which I failed to stress when I first looked at that August figure with you. Unemployment was up to 6 percent, 5.9 percent, in the month of August.

Next is the unresolved steel production-steel consumption situation. I have referred to the changing character of investment intentions and what this may imply about the situation immediately ahead. And, lastly, the political uncertainties that are developing in the fourth quarter of 1960.

These, then, are some of the reasons for the intensification of business interests in the analysis of the current position, and their alertness, the growing alertness of American industry, to what the barometers seem to be indicating about future business activity.

When we resume, I would like to take a few minutes to stress for you those elements of strength which suggest to this observer, and to at least an articulate minority group among business economists, that the fourth quarter may well be better than the third quarter; and that the worst of the adjustment may well be behind us than before us. But this is a minority view, and I want to stress at the close, first, the view of an increasing majority, and then by way of rebuttal, the positive views of a hopeful articulate minority.

(Break)

Just so I close on what I consider to be the right note, I would like to end with a recap of the elements of strength, having stressed, as I believe I should, the weaknesses in our economy.

The conclusion that I presented to you was that we were losing momentum as we move toward the close of 1961. Putting a positive note on that instead of a negative--decreasing rate of acceleration. This used to be the favorite Texas description of a recession--a slight loss in momentum. Decreasing rate of acceleration, but still sufficient momentum to yield a higher fourth quarter. My primary reason for believing that is the strength of end product demand, as I demonstrated it to you, through all three quarters of 1960.

Now, what expansionary forces conceivably can offset some of the elements of contraction that I have enumerated for you? I give you six.

No. 1, the change in our monetary policy and what this may do to investment, particularly in home building and heavy construction. Ease in monetary policy. The Federal Reserve has moved promptly and early.

Two--and this is already evident in the statistics--acceleration in our public highway program.

Three--and I hope our figures are correct--acceleration in the placement of defense contracts and defense spending within the framework of the budget.

Four, some emerging necessity for inventory accumulation in the fourth quarter or early 1961. Steel consumption, as best it can be measured, exceeds the rate of steel production. This should mean some upturn in steel in the fourth quarter, or, if not, in the first quarter of 1961--inventory accumulation because of the high rate of end product demand.

Nest, the continuing boom in Western Europe and the strength that gives to end product demand abroad.

Last, but no means least, the satisfaction of America's consumers with the compact car, and the probable strength of new model demand in the fourth quarter.

Now, these, in my mind, are sufficient, I believe, to give us a higher fourth quarter than third quarter. And I am still of the belief that the recurring demands of America's consumers, coupled with the pace of technological innovation, should give us a further extension of this prosperity phase into 1961, if not throughout 1961.

I now invite your questions.

QUESTION: In view of the decreased relative importance of manufactured goods as an economic indicator, and in view of the tendency to believe or the belief by some of the individual business forecasters collectively to see to it that their forecasts are realized, would it not be useful for the Committee to develop some kind of document indicating for those segments of industry not dealing with manufactured products?

PROF. GAINSBRUGH: I think that's a very useful suggestion. The Committee has been very busily engaged in seeing how this particular document could be improved; and I would suggest that you pass that suggestion on to them, for this reason:

I think we underestimate in our society--and Andy will do battle with me, I suspect on this one, -- the importance, the growing importance, of services as incomes rise and as we move more and more of our people from subsistence levels to the ways of life to which the new generation will aspire. We will want more and more things done for us. And some of this can be incorporated in manufactured products, such as the pre-packaged maid service built into the products in the kitchen, where domestic service itself is unavailable. But in many other instances the expansion areas are in the service sector.

This is a truism among economists: As the society's economic level rises, it shifts from the primary to the secondary to the tertiary industries. The under-developed countries rely primarily on agriculture and the extractive industries. Employment is heavy in those areas. As it moves along in its stage of development, employment contracts in agriculture and the extractive industries, and grows more in the manufacturing, construction, and related areas. These we call the secondary. And then, as levels of living continue to rise, they shift again the curve from the secondary to the tertiary, to the service component, both in the private as well as in the public systems, education being one of the service sectors. Higher levels of house rent being a second; culture being a third. As these become more prominent in the wants and desires of people, employment responds.

I think we ought to give far more attention than we do, not only to the current position of these industries, but also to their prospective position. Even within manufacturing, note the change in the compostion of employment--fewer and fewer blue collar workers, more and more white collar workers. Shifts from the production worker of the historic day, working with the aid of the machine, to the machine working with the aid increasingly of the research worker. And this too leads to a change in the income strata of manufacturing workers, as well as to a change in the character of their cost so far as the employer is concerned. These costs become far more fixed than variable in many instances. A whole series of changes arising from the shift toward the service industries, and we ought to be pursuing these far more intensively currently than we do.

QUESTION: I notice here in the chart of expenditures for plant and equipment that the revised figures for the second and third quarters have been revised down considerably. However, if we look at this, we find that it is higher than it has ever been in our history. What would have been the psychological effect on new orders had the original estimate been made somewhat near the figures we have now, or even lower, but still showing an increase in activity?

PROF. GAINSBRUGH: I think the major weakness of 1960, if I were asked to single it out, in the questions relating to the figures appearing on page 10, the major weakness of American industry in 1960 was over-expectation. They confused the decade 1960 with the year 1960, and they discovered, as 1960 ran its course, that it was only a tenth of the decade.

In instance after instance business is good. What is bothering the manufacturer in many instances is that it wasn't as good as he expected it was going to be; and he has had to adjust his sights downward. He's singing that 1960 is a good year, but it isn't as good as he expected it would be. And in many instances the figures shown here are the results of over-expectations for the year 1960 and beyond.

I think in all likelihood there will be less of a cut-back should contraction develop, in the figures on page 10 in the quarter ahead, than there were in the previous quarters following the peak of '53 or the peak of '57, because most of these investment programs are no longer designed to expand the capacity of the industries. These investment programs more and more are designed to cut costs, to tool out wherever possible high-cost labor, and substitute for it lower-cost machinery, more competitive machinery, that will improve the competitive posture of the given company within its industry, that will improve the competitive position of a given product relative to other products; but, even more in point, that will again give us some degree, a greater degree, of technological superiority compared with foreign countries that have lower labor costs.

These are some of the motivations behind this investment program. No longer just a sheer drive to expand steel capacity, or textile capacity, or chemical capacity. That was the rush of the first ten or fifteen postwar years. Get there with capacity. Market demand will take care of itself. Now the shift in emphasis is upon cost cutting, product innovation, plant relocation designed to intensify market demand, recognizing that capacity is more than adequate to meet market demand, and what you need now are elements of distinction in many ways that will attract demand.

So in this sense, because the emphasis is primarily upon almost self-generating types of investment-- as these are brought in, they generate demand--I think the investment potential is far more stable than it has been in past investment periods. And disappointing as these figures may seem to some, the emphasis was properly placed by my fellow optimists upon the high level of expenditures in plant and equipment that still continues to characterize industry.

In electric light and power, for example, they have just begun to increase their rate of expenditures. That may very well carry through 1961 and beyond, because there is a long lead time process. And in the area labeled "commercial and others," as you can see, there is a greater likelihood of continued expansion of investment than in the factory area.

I do not believe--to put a conclusion on this one--that the investment program, that the investment potential, is as unstable in the months ahead, even if there were contraction, as it has been in past periods of contraction.

QUESTION: Not that ignorance is bliss, but what psychological impact do you think that statistics such as are covered in here have in reference to the down trend that is predicted in the future?

PROF. GAINSBRUGH: This is a very pertinent question. As we develop our tools of economic analysis, so that they more accurately foreshadow subsequent operations in the economy, will we intensify the amplitudes of the cycle by releasing this information? Will there be a rush to climb aboard the band wagon if the foreshadowing statistics suggest contraction imminent in the course of the next quarter or the next half year or the next year? Will consumers be inclined to tighten up on their spending as they grow more conscious and more intimate with economic analysis and economic statistics?

This is a question which remains largely unresolved. I had it thrust at me by the Chairman of the Federal Reserve Board when we were doing a study for them. It was a question which they have debated internally. They have a lot of these foreshadowing statistics, collected by George Ketoins. Is it in the public interest to release them? They always have, but at some future period of time would they hurt or help conditions by releasing these statistics?

The answer I gave then I give this morning. I would much rather have diagnosis based on fact and prognosis based on fact than based on rumor or guess. And then put these things in perspective, and, if necessary, developed the proper programs of action to go along with the diagnosis or prognosis.

If you don't release these statistics, having collected them, then rumor replaces fact; and rumor, I think, would very often have the situation far worse than it actually is. I think this is a step forward--to have better and better diagnosis and prognosis, and then to build your program of action to go along with it.

QUESTION: This will have to be the last question. No one has asked about European production.

PROF. GAINSBRUGH: That was below the belt, but I rode in Andy's car this morning.

DR. KRESS: I know, but I'd like him to say, on the point that you raised a minute ago, what will be the long-run effect of European production on American capital and European competition?

PROF. GAINSBRUGH: I suspect this is one that will be debated intensively irrespective of whatever answer I give.

I think the answer to European competition has to be intensification of competition on our part. I believe the boom in Western Europe assures us of a higher level of economic activity rather than a lower level of economic activity. In other words, I would subscribe to the thesis that what we must do is not to limit the influx of foreign goods into the USA, but, rather, to improve our position via particular technology so that we can compete more effectively in foreign markets, even more effectively in foreign markets in the 60's than we have in the 50's and the 40's.

Is that the note that you would like me to stress, Andy? Irrespective of that, this is the one I would stress. There are two schools that are rapidly emerging. One such school--and it has an increasing number of advocates not only among management, but among labor--is that production costs are so low abroad that the only way we can resolve our problem of the balance of payments is to limit the influx of imports. The other school, to which I belong, is of the belief that we must raise our level of exports via emphasis upon technology, including paying more attention to the dislocations that develop at the regional and local level, than we have in the past; but nevertheless working down the road of increasing our exports, so that we have a sufficiently favorable balance of trade to permit us to do the things that are required in the field of the under-developed countries, military posture, and so on.

DR. KRESS: Gentlemen, I'd like to say just a word here before I thank Professor Gainsbrugh. What he has been doing for you here this morning is to teach you to read the statistics. He has not had as his primary purpose telling you what the economy is going to do or is doing or is likely to do, although he had to bring in a great deal of that in order to make the statistics clearer for you. I want to point out that it is in February, in the Economic Stabilization Unit, that we will try to emphasize what is going on and what is likely to go on in the economy generally. This is preparatory, to get you to thinking along these lines.

Now, Professor Gainsbrugh had to rearrange his entire set of affairs to come here today. This was the best time, in this unit, for him to come. He came at considerable sacrifice and has to be in New York at six o'clock without fail tonight, and with that fog up there, that may not be easy.

Morty, we thank you very much for rescuing us once more and getting us off to a nice start.