AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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WEEKLY BULLETIN

January 23 1950

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Work of the Council of Economic Advisers

Within the past few weeks the President's state-of-the-Union message, his Annual Economic Report, the Council of Economic Advisers' Annual Report, and the Council's Annual Economic Review have been presented to the public. That such reports have been seriously offered as economic analyses is more than sufficient proof that the scientific method has not been used by the Council; and that the economic profession (if it may be so-called) has not immediately denounced these reports and their authors is further evidence that the standards of the profession are so low as to constitute no barrier to the entrance of any skillful manipulator of words who chooses to pass as an economist.

On other occasions we have criticized the advice given by the President's Council of Economic Advisers. We have pointed out repeated failures to apply the scientific method; we have indicated the Council's use of unrevealed assumptions; we have noted the injection of political analyses into the Council's reports; we have revealed glaring inconsistencies and dangerous rationalizations; we have pointed out the numerous attempts to deal with symptoms and ignore underlying causes; and finally we have suggested a plan for reorganization of the Council of Economic Advisers in order that the Nation's need for economic advice might be better served. We should like to be able to find in the most recent reports even the promise of some improvement. Unfortunately, all of our earlier criticisms are again in order. Moreover, what is even more discouraging, the reports reflect such inadequate conceptions of economic knowledge on the part of the Economic Advisers that policies based on their advice may cause irreparable damage to the Nation's economy.

Principal Deficiences

One major deficiency is the Council's apparent assumption that facility with words is knowledge. A second serious deficiency is the repeated use of inconsistent and otherwise faulty analysis.

The use of words for their emotive, soothing, or other effects rather than for the purpose of conveying specific information has long been recognized as a major failing of many social scientists.[1] Consequently, semantics (the science of language as it is used for communication) has become an indispensable tool of the economic scientist. Either the Council members are inadequately trained in the use of this essential tool, or they are deliberately using impressive and pleasing words and phrases in order to lead readers to believe that knowledge is available where in fact there is only ignorance.

"Profit is *good* when it is *reasonable* * * * *adequate* funds for a *rewarding level* of profits * * * stimulate a *high enough* level of investment * * * obtain for labor a *fair* share of the benefits of our economic system * * * a *fair* distribution of our increasing prosperity * * * supporting farm income at *fair* levels * * * fall below *desired* levels * * * who cannot now obtain *adequate* financing on *reasonable* terms." [Italics supplied.]

The italicized words can mean "all things to all men." One cannot object to reasonable profits, to a fair distribution, to fair levels of prices, or to reasonable terms. Yet, upon reflection, no one really knows specifically what the Council means by "reasonable" or any of the other phrases.

The Council describes the trend "in the attitude of government toward business as being away from the purely negative or policing function and toward the affirmative or facilitative approach" and later states that "relatively more emphasis in price-support legislation should be placed upon livestock items if a positive, forward-looking farm program is to be developed." Three questions immediately arise: first, what is an affirmative approach? second, why are so-called "affirmative" or "positive" policies any more desirable than so-called "negative" policies? third, what does "forward-looking" mean?

Fiscal, credit, and monetary policies are described as affirmative Government policies. Evidently the easy-

Note: The annual reports rendered by the President's Council of Economic Advisers are obviously intended as the Council's basic interpretations of its statutory instructions and its fundamental analyses of economic relationships. The Council's other reports are also important, because they present the application of the Council's fundamental analyses to current problems. These documents are potentially of such great significance to the future of the United States that we have devoted almost this entire bulletin to the discussion under this heading.

[1]The Social Science Research Council reported in a recent bulletin: "Social science departments in general appear to be so fearful of deferring potential students that they tend to adapt their requirements to the tastes of the least competent. Consequently verbal facility, rather than a scientific attitude and mastery of scientific principles and techniques, is too generally the criterion of achievement in what are called the social sciences in undergraduate colleges; and this criterion carries over perceptibly into the graduate schools.

money policy, which supplies inflationary credit, is "affirmative" because the Government actually does something rather than prohibits something. Nevertheless, an easy-money policy that in effect *prohibits* price decreases can certainly be described as a "negative" approach to the problem of inflation.

But even if a real distinction could be made between "affirmative" and "negative" approaches, there is no reason for believing that one type is better or more effective than the other. Of course, "affirmative" has more pleasant connotations than "negative"; consequently, the Council members may appear to be saying something of great significance when they describe the trend from "negative" to "affirmative" methods of government.

As to "forward-looking," the Council evidently is referring to the idea that a policy that looks ahead is better than one that takes no cognizance of the future. Unfortunately, "forward-looking" may be beneficial or not, depending on what one is looking forward to. A policy that looks forward to destroying the competitive market system of making prices may be labeled "forward-looking," in one sense of the phrase, but it is nevertheless a primitive policy that was seriously questioned even before Adam Smith exposed its defects nearly two centuries ago.

Faulty Analysis

Behind the screen of verbiage in these reports is a veritable swampland of faulty analysis. By means of unsound generalization, unrevealed assumptions, the building up of "straw men," faulty logic, statistical inadequacies, inconsistencies, and inadequate definitions, the Council has created a quicksand foundation for its development of economic policies.[2]

Unwarranted generalizations are especially frequent. One example in "The Annual Economic Review" submitted by the Council is as follows: "The practical dynamics of our economy indicate that a fairly stable general price level and a rising level of money income as productivity increases are more conducive to business confidence and to the expansion of enterprise than a generally declining price level. * * * And since wages constitute the bulk of personal income, the soundest general formula, once wages, prices, and profits are in a workable relationship, is for money wages to increase with productivity trends in the whole economy." We know of no scientific bases for such generalizations.

Unrevealed Assumptions

Unrevealed assumptions also are frequent. For example, "We should expect that in such an economy [one of high employment and production] a higher level of business investment in plant and equipment could be attained without imposing upon corporations financial requirements as high as during the period 1946-48. The reason for this is that probably not more than 3 to 4 billion dollars annually would be needed in an enlarging economy to expand inventories and customer accounts in line with sales." The Council has not indicated what assumptions it has made regarding sources of funds in the future to replace the large accumulations of depreciation funds that were not used during the war but that were available for the use of corporations in the 1946-48 period.

The unrevealed assumptions that underlie the following statement are especially important in view of the great stress the Council has placed on economic growth and stability. " * * * the problems of growth and stability are closely related. Affirmative efforts towards balanced growth are our main shield against serious periodic downturns. And the prevention of such downturns will remove the great obstacle to the speed and certainty of our long-range growth." Evidently the Council has unwarrantedly assumed that because two developments are related they are interdependent.

"Straw Men"

Although the "straw man" technique (the method of "proving" one's own point by offering an absurd counterargument that is easily demolished) may be useful as a debating weapon in order to confuse the issue, it is out of place in a serious analysis of economic trends. Even more disturbing is the possibility that the Council may be unaware of the fact that it has been guilty of using that method.

Not content with the usual "straw man" technique, the Council has introduced a variation of the procedure. This variation is the presentation of a statement and the seeming disproof of it by discussing another but related subject. For example, the Council asserted in the Annual Report, "Occasionally it is said that a level of employment below the maximum is desirable because it makes workers more efficient and improves productivity." The Council then presents two paragraphs on "mass unemployment." Certainly "a level of employment below the maximum" is related to unemployment, but the original argument is not at all concerned with *mass unemployment.*

Fallacies

In the first section of its Annual Report the Council states: "In sober retrospect, not even the great depression of the 1930's altered the basic character of our economic system or reduced the commitment to it by the people. * * * It follows that nothing less than another depression even more devasting *could* break us away from this basic commitment." [Italics supplied.] The Council then goes on to warn of the break-down that could be caused by a more devastating depression. However, that a more devastating depression *would* cause us to break away from our basic commitment does not logically follow. To assert that "nothing less than another depression even more devastating could break us away" says nothing about how bad a depression would break us away or *whether or not* a depression could break us away at all.

Still another fallacy is found in the Council's discussion of "compensatory" spending by the Government during depressions. "The experience in the 1930's, however, demonstrated that action by the government became entirely necessary [mere assumption, a recovery actually was under way in 1932] *but was not alone sufficient* to restore and maintain satisfactorily high levels of general economic activity." The Council finally asserts: "This leads to the conclusion that 'compensatory' public action can help to iron out minor fluctuations of the business cycle and must indeed be used if big ones develop, but that complete recovery from a substantial downswing depends primarily upon the revival of private investment." As far as we can discover, nothing that the Council has demonstrated "leads to the conclusion" that it has arrived at. The actual experience leading to the Council's conclusion was simply that public

[2]Space requirements limit us to only a few examples of the faulty analysis found in the economic reports.

action was taken and was not " * * * sufficient to restore and maintain satisfactorily high levels of general economic activity." That experience certainly *does not* lead to the Council's conclusion that " 'compensatory' public action *can* help to iron out minor fluctuations of the business cycle and '*must indeed be used*' if big ones develop * * *. " [Italics supplied.]

Statistical Shortcomings

Although neither the President nor the Council is directly responsible for the statistics compiled for their use, in some instances an unqualified acceptance of the data has led to erroneous deductions. Included in the chart of the total money supply are time deposits, currency outside banks, and adjusted demand deposits. The inclusion of time deposits, which are merely records of funds long since turned over to the banking system for investment, makes the Council's conclusions regarding effective demand or total purchasing media in circulation quite erroneous.[3]

A second statistical shortcoming is found in the personal-savings data compiled by the Department of Commerce and the Securities and Exchange Commission. In calculating net personal savings, the value of the purchases of new homes is added to the increase in liquid assets, and residential mortgage debt is subtracted. On the other hand, although consumer debt is a subtractive item from increases in liquid assets, the latter figure does not include the value of purchases of automobiles nor any of the other consumer durable goods for which consumer debt is contracted. Furthermore, the fact that corrections found necessary in order to adjust statistical discrepancies were 25 percent of net personal savings in 1946 is further evidence of the caution necessary in using such data.

Inconsistencies

Contradictions or inconsistencies within the reports certainly are not compatible with useful economic analysis. For example, the Council states: " * * * efforts to promote expansion of the total production and income of the economy are more significant than measures to 'redistribute' the current product. In any economy foredoomed to inability to provide an adequate or rising standard of living for all industrious families, there might be some reason for according the resharing of output *priority* over efforts to increase output. * * * But the notable expansion in production which our economy has achieved in the past and can certainly repeat or excel in the future, coupled with the observed fact that this so much lifts the general standard of living, should receive foremost consideration in economic programs and policies." In the very next statement the Council bluntly exclaims, "Of course, we *cannot postpone* [that is, we must give priority to] efforts to improve the lot of the underprivileged until they can be lifted to reasonable levels by the lever of general growth." [Italics supplied.]

Ignorance About Inflation

Referring to the 1948-1949 recession, the Council says: "The successful combination of private and public actions, which limited the recession of inflationary forces to a moderate and brief downturn in business, justifies an optimistic outlook for the coming months and confidence that we shall be able to deal with the problems of a somewhat more remote period. * * * The inevitable end of the inflationary process has come."

Unfortunately, the facts of the matter are (1) a major inflation cannot be liquidated without a major deflation, (2) the inevitable end of the inflationary process has not come, and (3) the degree of inflation today is greater than in any prewar period, higher than that of 1920, 1929, or 1937, and has been increasing since March 1949.

The Council's apparent ignorance of the actual inflationary situation and its failure to employ the scientific method have led to several remarkable observations on the present economic outlook and the long-range future.

"In the first place the outlook for the next few months will be even brighter if our system of free enterprise * * * grows in confidence that rising prosperity is not to be short-lived and that *we need not again* be confronted by disruption or concern even as great as that of early 1949." [Italics supplied.] There is little question that the resumption of an inflationary boom instills confidence, a confidence that aids in accentuating the boom. But as businessmen who lived in the late twenties will remember, confidence based on the effects of inflation can be seriously misleading. That "we need not again be confronted by disruption or concern" should sound vaguely familiar to those who remember the "new era" of the 1920's.

Economic Growth and Stability

Much of the Council's reports emphasizes the problems of economic growth and stability. The analyses of these problems, analyses that also include shortcomings such as those already mentioned, are additional evidence that the scientific basis for much of the reports is inadequate.

The Council argues, "Such an interpretation makes it clear that the problems of growth and stability are related." The interpretation that "makes it clear" is as follows:

"In its Fourth Annual Report to the President * * * the Council singled out confidence in future growth as a prime conditioning factor of the American economy. In stressing the potentialities for growth, we do not propose a blueprint for the whole economy, but rather attempt to define the opportunities for future markets. This not only may serve as a guide for the course of public policy along constructive lines, but may also help to meet the needs of private business for basic bench marks for development of their programs and policies.

"We have stressed the fact that only through such growth could the various economic groups in this country prosper and progress together, instead of engaging in bitter and hopeless conflicts to obtain for themselves larger shares of a static national output." Surely the Council does not mean that "such an interpretation" makes clear the relation of stability to growth. Moreover, until the Council has made a thorough analysis of the reasons for "booms" and "busts" in the past, we do not understand how a useful discussion of the problems of stability and growth can be offered.

The Council has suggested: "Measures directed specifically toward improving the productivity and incomes of low-income groups have favorable impact upon the whole economy." This is mere idle assertion for which the Council has offered no proof.

The Council apparently has overlooked completely

[3]See "Distinction Between Time and Demand Deposits," pages 12-16, in *Cause and Control of the Business Cycle* by E. C. Harwood.

the fact that growth is a composite result of dying plus rapidly expanding industries. The removal of employees and assets from dying industries is essential to the rapid growth of other industries. Attempts by the Government to aid all depressed sectors of our economy would result in the perpetuation of relatively inefficient factors of production to the detriment of the over-all rate of growth.

The Council's growth objectives for 1950-54, its private investment estimates, its remarks relating to a high consumption economy, and its suggested fiscal policy are all based on the belief that "we are not immediately threatened either by inflation or deflation" and that "the inevitable end of the inflationary process has come." Available facts prove that the inflation of the past several years has not been liquidated; therefore, the notion that it has is potentially dangerous. Plans based on the supposition that today's inflated level of business activity is evidence of a balanced economy may lead to the creation of even more serious maladjustments than those already existing.

The Distribution of National Income

In this connection, the Council has asserted: "In an expanding economy, the lifting of low-income families to a far higher standard of living, the improvement of agricultural programs consistent with the needs of urban consumer incomes and also promoting parity of income for the farmer, the provision of adequate funds for a rewarding level of business investment and profits, and the meeting of our domestic welfare and international security requirements, are not incompatible objectives. Attainment of each objective is inseparable from attainment of the others."

The views of the Council evidently are not based on an analysis of the reasons for the existing distribution of the fruits of the technological advance. Various assumptions appear to have been made as to what constitute "fair" or "reasonable" or "desirable" levels of wages, profits, interest, or rent, and the Council has simply decided that price-support programs are necessary for the farmers, unemployment benefits are necessary for the wage earners, and social-security programs are necessary for the retired individual. The Council seems not to have investigated why farm prices are not sufficient to maintain the assumed "fair" level of farm income or why wages are not at the assumed desirable levels. As a result, the economic reports are filled with plans to alleviate symptoms rather than policies aimed at the modification of underlying causes.

Two questions should be answered before recommendations such as those presented in the economic reports are offered: first, what is the most desirable distribution of wealth? and, second, what are the reasons that account for the present distribution of currently produced wealth? Given the answers to these questions, proposals to change the situation might at least have some chance of producing the desired results.

Conclusions

The foregoing is hardly more than a hasty sketch of the important defects in the reports offered by the Council of Economic Advisers. Nevertheless, we believe that these comments explain sufficiently our assertion that the analyses presented by the Council are hopelessly inadequate and that the Council's recommendations lack a sound, scientific basis. That such recommendations may be extremely dangerous should be evident to anyone who has even an elementary grasp of the economic facts of life.

However, we see in these reports something even more sinister in its implications for the future of our economy than the mere presentation of unsound recommendations. We can find only two possible explanations for the nature of these reports. Either the Council is blissfully unaware of the vast extent of its ignorance and is laboring under the delusion that omniscience has been granted to its principal members by some means; or those who dominate within the Council are exceedingly clever and ruthless men determined to change the American economy and remold it in such a manner as to hasten the coming of a socialistic state under their direct or indirect domination.

We do not pretend to know *which of these explanations is correct. However, we seriously doubt that simple, misguided men would be as clever in their juggling of language, as consistently inconsistent in certain respects, and as smoothly articulate in their attempts to sugar-coat the poison pills offered as cures for the Nation's economic ills.*

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 98.2 percent of capacity for the week ended January 21, 1950, was 1 percent more than production in the preceding week but was 2 percent less than that in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Percent of Capacity†	83	26	81	31	100.1	98p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.84	1.84
Production (Million Tons)	1.15	.40	1.22	.48	1.84	1.80

Automobile and truck production during the week ended January 14, 1950, in the United States and Canada was estimated at 155,164 vehicles, compared with a revised total of 116,768 vehicles for the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Vehicles (000 omitted)†	107	32	92	66	113	155p

Electric-power production in the week ended January 14, 1950, increased to 6,028,589,000 kilowatt-hours from 5,695,372,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Billion Kilowatt-Hours†	1.74	1.60	2.24	2.12	5.73	6.03

Lumber production in the week ended January 7, 1950, decreased. *The New York Times* seasonally adjusted index was 0.3 points below that for the previous week but was 21 points above that for the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
The New York Times Index†	132	39	101	69	78	99*

†Latest weekly data; corresponding weeks of earlier years
p=preliminary; *holiday

Department-Store Sales

Department-store sales for the week ended January 14, 1950, were 13 percent more than sales for the previous week but were 5 percent less than sales in the corresponding week last year.

PRICES

Commodities at Wholesale

(August 1939=100)	*1949 Jan. 19*	*1950 Jan. 12*	*1950 Jan. 19*
Spot-Market Prices (28 basic raw materials)	287	250	249
Commodity Futures Prices (Dow-Jones Daily Index)	286	282	281