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The President's Economic Report

In submitting his *Economic Report*, President Kennedy has continued the procedure he re-established last year.* The portion of the report signed by him requires 20 pages and is followed by 268 pages constituting the report of his Council of Economic Advisers.

In their report last year, the Council of Economic Advisers asserted "The prospect for 1962 is a continuation of the favorable trend of 1961. * * * The favorable prospects for private demand, together with current economic programs and proposals of the Administration, point to a strong and sustained expansion." They estimated Gross National Product for 1962 at $570 billion. If uniform gains in successive quarters of the year were assumed, GNP at the end of 1962 should have approximated $600 billion, but the actual figure was $562 billion.

In commenting on this forecast a year ago we said "In their analyses and recommendations for stimulating economic growth, the President's economic advisers demonstrate how the Keynesian notions restrict the vision of any economist who accepts them. The economic advisers argue that '* * * full employment is easier to maintain under the budget program with the smaller surplus, because less private demand is required.' In other words, the Government should incur large deficits and be careful to avoid large surpluses in order to foster economic growth. * * * How could the Nation have been prosperous from 1919 to 1928, when the World War debt was being reduced by one-third? * * * Apparently anyone who wears the Keynesian glasses either does not see such facts or sees them in some upside-down perspective that negates their obvious significance.

"The Council asserts, 'The favorable prospects for private demand, together with current economic programs and proposals of the Administration, point to a strong and sustained expansion.'

"We deny that such predictions can be other than guesses in view of the current status of the scientific advance in economics. This prediction is based primarily on the same economic dogmas used in formulating predictions of a great depression following World War II. Events may develop as the Council has predicted, but that would prove not that the forecasters' analyses were sound but that they had guessed correctly.

"The President's councilors overlook a vitally important fact. Their pet panacea, inflating the purchasing media, has been almost continuously applied in the United States during the past 20 years. Some of the application was inadvertent in that it was not planned by Keynesian economists or others, but in practical effect it has been strictly in accordance with the Keynesian prescription. Are the consequences assured prosperity and sustained economic growth?

"On the contrary, application of the Keynesian panacea for two decades has fostered numerous serious economic distortions in the United States, distortions reflected today in unnecessary unemployment, stagnation of major industries, extensive depreciation of the dollar, loss of world markets, and fully justified loss of confidence in the dollar. An economy that could be the wonder of the world now falters, not even in second place but nearly the most backward, judged by rates of growth for the world's industrial economies. Such are the consequences of applying the Keynesian notions over a prolonged period. The Council of Economic Advisers not only fails to see the obvious facts but recommends

*For the benefit of recent subscribers we summarize our earlier comments on this subject. When President Eisenhower in 1955 changed the earlier procedure and assumed responsibility for the document in its entirety we said:

"Although we, and probably other economic analysts as well, should like to have available the report of the Council on which the President's report presumably is based, the present practice seems, on the whole, to be preferable to that followed earlier. The members of the Council are now free to advise the President as economic scientists and need give no consideration to the political implications of their reports to him, a most desirable situation."

We believe that, in reverting to the earlier procedure, President Kennedy has adversely influenced the scientific usefulness of his advisers' work. Obviously, they cannot now even pretend to function as economic scientists but must function as pseudo-scientific special pleaders for the various proposals that the President chooses to advocate. For example, if there is any one thing on which economists are agreed, it is that an arbitrary increase (above the free-market rate) in the price of a production factor (land, labor, or capital) must lessen the demand for that factor and hinder production. Yet the Council, in its portion of the 1962 report, listed the 1961 increase in the minimum wage as part of the "Program for Economic Recovery and Growth." We believe that few unbiased economists would maintain that an arbitrary increase in the price of the labor factor above the free-market rate could do otherwise than impede business expansion and retard economic growth.

When the increase in the minimum wage was under consideration by Congress in 1961, Dr. Gottfried Haberler, a distinguished economist at Harvard, wrote a letter to the *New York Times* (February 12, 1961) in which he deplored the proposed action and asserted that the arguments being used to support it should make "any economist blush." Moreover, we have no doubt that all three of the President's economic advisers always have taught their college classes the precise opposite of what they now imply. Other instances could be cited, but it seems unnecessary to belabor the point that economists who prostitute their professional talents to serve political ends cannot be relied upon as scientist advisers even if they had been economic scientists in the first place.

In an appendix to their 1963 report, the Council of Economic Advisers presents a "Review of 1961-62 Legislative and Administrative Actions to Strengthen the Economy," wherein they do *not* list the increase in the statutory minimum wage. Whether they now consider that change not worthy of mention or perhaps have revised their views because of the continued large number of unemployed is not explained.

more of the same erroneous prescription that, instead of fostering prosperity and sustained economic growth, has prevented them."

This year, undismayed by their lack of success as prophets last year, the Council of Economic Advisers again offers an estimate of GNP for the year. This time the figure is $578 billion, but they cautiously suggest "plus or minus $5 billion." Nevertheless, they assert that, "Our review shows that progress is not likely to be interrupted in the near future by a recession of the type experienced in 1949, 1953, 1957, and 1960." Again we point out that such predictions lack any scientific basis.

Moreover, the Council predicts "Under the stimulus of tax reduction and reform, the years ahead promise to write a new chapter of full prosperity and rapid growth in our economic history." If the Council members contemplated that tax reductions would reflect curtailment of expenditures resulting from abandonment of the farm program, from greatly reduced aid to nations of the world attempting to make socialism work, and from economies in defense and other spending, we should be inclined to agree that such an outcome would be probable. The probability of such favorable results would be further increased if there were some prospect that the Government, by lessening the power of union monopolies, would encourage the readjustments needed to remove existing distortions of the economy, such, for example, as the high costs in the automobile industry that inhibit long-term growth.

But the Council of Economic Advisers does not even recognize the possibility that numerous distortions within the economy are preventing the growth so badly needed. To them, the situation is simple. Their diagnosis is: "In the past 5 years total demand has not been adequate to promote rapid growth of incomes. * * * As a result, inadequate demand remains the clear and present danger to an improved economic performance."

While claiming sophistication and erudition for themselves and insisting that the public should be educated to understand the economic panacea they advocate, the Council members exhibit a naiveness about matters economic that long has characterized the disciples of Lord Keynes. How did economic progress ever occur before their deficit-spending notions became popular? How did the United States enjoy the most prolonged and rapid economic growth in its history (from 1875 to 1890) while following a precisely opposite course to that which they advocate? How did West Germany, after recovering to prewar production levels and after aid from the United States ceased, continue to experience a decade of rapid economic growth while following policies the opposite of those now advocated by the Council of Economic Advisers? Why the sudden and great collapse in 1937-38 after the United States had applied in 1935-36 the spending "remedy" recommended by Lord Keynes himself to President Roosevelt?

Completely disregarded by the Council of Economic Advisers, at least as far as their report is concerned, is the possibility that segments of the economy have become so distorted by high levels of wages and other costs that exchange of products is hampered, both domestically and abroad. The Council does not see one of the most obvious facts of recent years, i.e., that repeated applications of their pet panacea, more inflationary issues of purchasing media, have encouraged monopoly unions and complacent management to agree repeatedly on still further distortions that have made the situation worse after each successive dose of the inflation medicine.

Conclusion

We therefore conclude that the *President's Economic Report,* especially the major portion provided by the President's Council of Economic Advisers, is scientifically unsound and reflects primarily the naive economic views of modern John Laws, who are the equivalent in the economic field of the alchemists or of seekers for perpetual motion. If their proposals are accepted, we predict that the Nation's economy will continue on the course that already has brought it near the brink of a major disaster.

What the Indicators Say

Percentages of the three groups of indicators expanding are plotted on the accompanying chart, with periods of cyclical contractions as determined by the National Bureau of Economic Research indicated by shaded areas.†

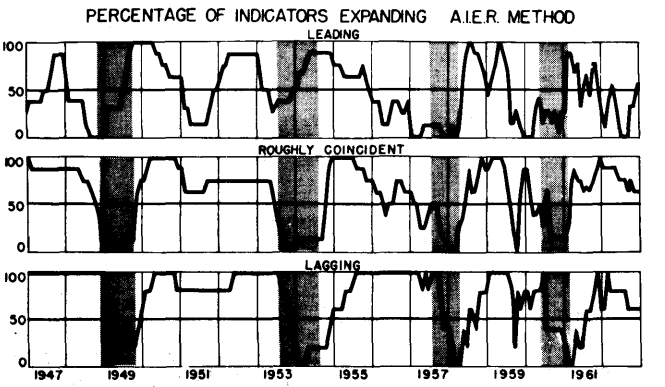
The leading indicators continue to portray a somewhat confusing mixture of improving and deteriorating individual series, currently estimated to average at a moderately favorable but vulnerable status. Weaknesses are most pronounced in the recent trends of new orders for durable goods and the average workweek; almost equally significant weaknesses are observed in the employment accession rate and prices of industrial raw materials. However, common stock prices continued to increase through January, business failure liabilities improved slightly in December, and the factory layoff rate remained unchanged as last reported. We continue to classify the two construction series as expanding despite one-month decreases in December. The percentage of primary leaders expanding is 56.

A majority of the roughly coincident series also were expanding at last reports, with weakness evident only in the unemployment rate for January and in industrial wholesale prices as estimated for January.

With December increases reported in manufacturers' inventories and consumer installment debt, 60 percent of the lagging indicators still were expanding.

An upward trend in a majority of the leading indicators, although tentatively indicated, is not yet clearly defined. They appear to forecast a moderately favorable prospect for business activity during the next several months, which may prove to be a continuation of the relative stability experienced since last spring.

†The cyclical status of each indicator is determined by visual inspection and by appraisals of related series. The indicators are grouped as "leading," "roughly coincident," or "lagging," according to their past relationships to peaks and troughs of business cycles.



SUPPLY

Industrial Production

Production of steel, automobiles, electric power, and lumber (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

Steel	*1929*	*1932*	*1956*	*1960*	*1962*	*1963*
Ingots—million tons						
1 week: February 2	1.17	0.41	2.44	2.73	2.45	1.87
4 weeks: February 2	4.64	1.66	9.77	10.92	9.48	7.56
Automobiles						
Vehicles—thousands*						
1 week: February 2	109	29	174	216	172	197*p*
4 weeks: February 2	419	122	702	849	695	788*p*
Electric Power						
Kilowatt-hours—billions						
1 week: February 2	1.7	1.6	11.5	14.3	16.4	18.2
4 weeks: February 2	6.9	6.4	46.2	57.4	67.0	72.1
Lumber						
New York Times Index						
1 week: January 26	144	39	140	142	94	n.a.
4 weeks: January 26	141	40	138	134	105	n.a.

* Cars and trucks in the United States and Canada.
p Preliminary.
n.a. Not available.

DEMAND

Purchasing Media

Total purchasing media decreased $3.9 billion in January to $148.6 billion, 2 percent more than that at the end of January 1962. Subtraction of an estimated $11.9 billion of inactive purchasing media‡ from this total indicates that purchasing media actively in use at the end of January totaled $136.7 billion, about 2 percent more than the total of a year earlier.

Inflationary purchasing media decreased $2.8 billion in January to $78.0 billion, which was slightly less than the total at the end of January 1962. The greatest part of inflationary purchasing media (derived chiefly from real estate, security, and consumer loans granted by the commercial banks, and from the banks' investments in obligations of corporations and State and local governments) decreased $2.8 billion during the month to $45 billion, 12 percent more than that at the end of January last year. The next largest component of inflationary purchasing media, that derived from monetization of the Federal debt by the commercial banking system, remained the same at $29.2 billion in January but was 15 percent less than that of a year earlier. The remaining relatively small and stable amount of inflationary purchasing media, derived from silver and from the general credit of the U.S. Government and circulating as Treasury currency, was unchanged in January at 3.8 billion but was 4 percent more than that at the end of January last year.

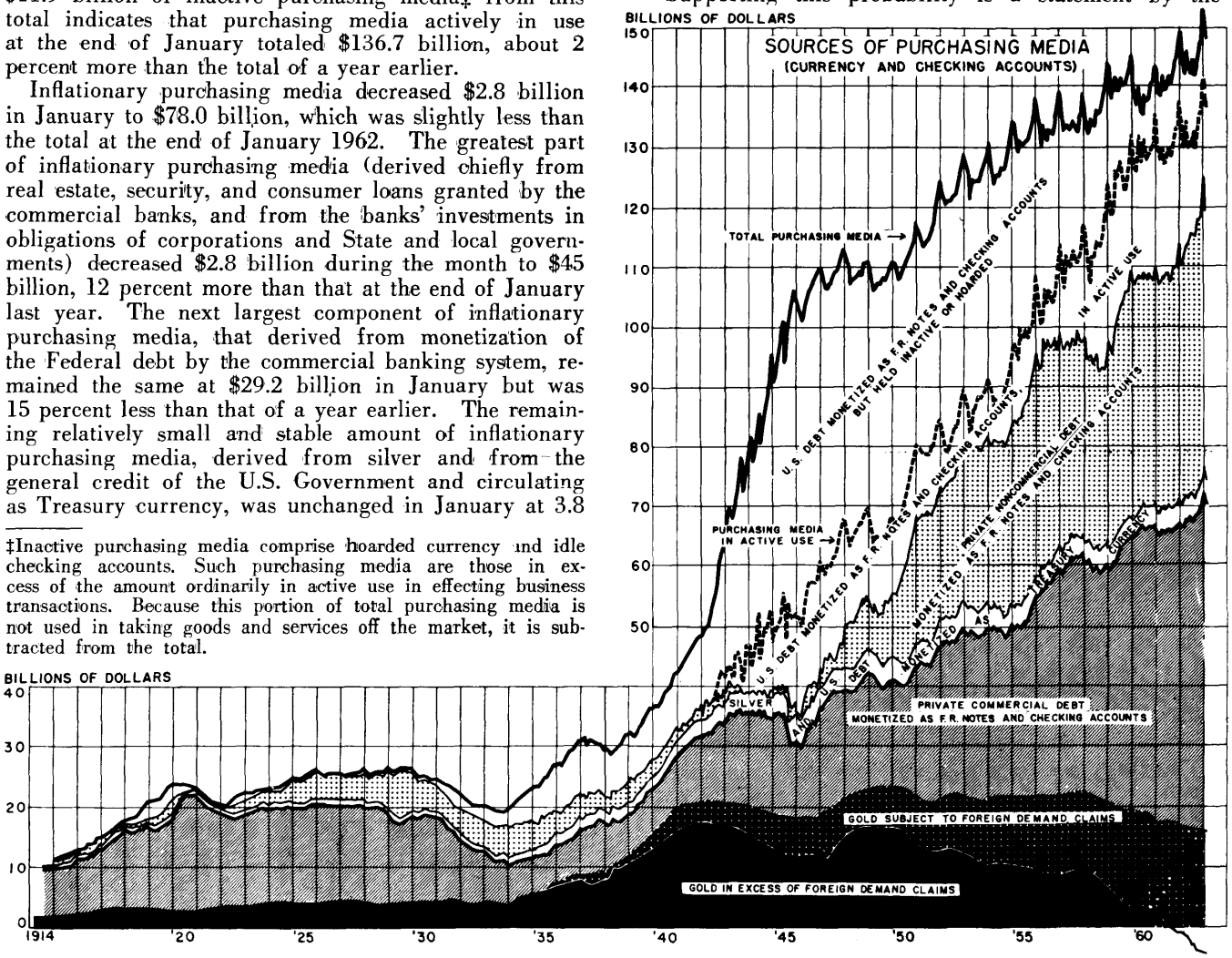
Noninflationary purchasing media, derived from gold and from commercial, industrial, and agricultural loans, decreased $1.1 billion in January to $70.6 billion, 5 percent more than the total at the end of January 1962. The amount derived from commercial, industrial, and agricultural loans decreased $1.1 billion during the month to $54.7 billion, 9 percent more than that at the end of January last year.

The gold stock of the United States was $15,928 million at the end of January compared with $15,978 million at the end of December and with $16,815 million at the end of January 1962. Gross foreign short-term claims against the U.S. gold stock were last reported at $25,174 million at the end of November, partly offset at that time by short-term claims against foreigners of $4,864 million. If these totals were unchanged in December and January, net foreign short-term claims would exceed the U.S. gold stock by $4,382 million, compared with $977 million a year earlier.

As a result of President Kennedy's tax-cut proposal last month many people concluded that another wave of inflation soon would sweep over the country. Why, contrary to this expectation, little or no inflation probably will result from the measures proposed, for a year or more at least, was explained in our article, "State of the Union," in *Research Reports*, January 21, 1963.

Supporting this probability is a statement by the

‡Inactive purchasing media comprise hoarded currency and idle checking accounts. Such purchasing media are those in excess of the amount ordinarily in active use in effecting business transactions. Because this portion of total purchasing media is not used in taking goods and services off the market, it is subtracted from the total.



Chairman of the Federal Reserve Board in which he indicated that if further monetization of Federal deficits were attempted, the Board would be "on guard against two dangers: first, * * * that too rapid * * * monetary expansion would * * * produce rising * * * costs and prices as well as unwise speculation and in this way curtail exports and overstimulate imports; and second, * * * that too easy domestic credit availability and too low borrowing costs would encourage capital outflows."

That the agency controlling the Nation's supply of purchasing media is aware of these dangers is fortunate; but, judging from past experience, such awareness is not a guarantee of appropriate future action.

A further reduction in the amount of inflationary purchasing media in use is expected during the next several months.

Department-Store Sales

Sales of department stores reporting to the Federal Reserve banks compare with those of corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended February 2	+1
Four weeks ended February 2	+3
Year to date	+4

PRICES

Commodity Prices

	1962	*1963*	
Index	*Feb. 4*	*Jan. 28*	*Feb. 4*
Spot-market, 22 commodities	258	n.a.	n.a.
Commodity-futures	309	308	304
Steel-scrap	$36.83	$27.83	$28.17

n.a. Not available.

Note: The indexes are respectively those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age*. The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price for No. 1 heavy melting scrap.

BUSINESS

Manufacturers' Orders, Sales, and Inventories

Note: Data for new orders, sales, and inventories are seasonally adjusted; data for unfilled orders are not so adjusted.

New orders received by manufacturers during December were 2.5 percent less than those received during November but 0.2 percent more than those for December 1961. New orders for durable goods, a leading indicator of business-cycle changes, were 3.3 percent less than those of a month earlier and 2.7 percent less than those of the corresponding month last year. New orders for nondurable goods were 1.7 percent less than those of a month earlier but 3.1 percent more than those received during December 1961.

Sales (shipments) of manufacturers in December were 0.7 percent more than those of a month earlier and 3.8 percent more than those in December 1961. Sales of durable goods were 0.3 percent more than those in November and 3.9 percent more than those in the corresponding month last year. Sales of nondurable goods were 1.1 percent more than those in November and 3.7 percent more than those in December 1961.

Inventories of manufacturers at the end of December were 0.5 percent more than those of a month earlier and 4.1 percent more than those of a year earlier. Inventories of durable goods manufacturers increased 0.3 percent during the month and were 4.1 percent more than those of a year earlier. Inventories of manufacturers of nondurable goods increased 0.9 percent during December to an amount 4.3 percent more than that of a year earlier.

The ratios of inventories to sales for manufacturers of all goods, durable goods, and nondurable goods for December compare with those for a month and a year earlier as follows:

	1961	*1962*	
	Dec.	*Nov. r*	*Dec. p*
All goods	1.70	1.69	1.71
Durable goods	2.01	1.98	2.01
Nondurable goods	1.42	1.41	1.42

r Revised. *p* Preliminary.

Unfilled orders of manufacturers at the end of December were 6.2 percent less than those at the end of December 1961. Unfilled orders for durable goods were 5.9 percent less than those of a year earlier. Unfilled orders for nondurable goods, about 6 percent of the total, were 10.7 percent less than those at the end of December 1961.

Decreases in manufacturers' new orders, especially those for durable goods, suggest that manufacturing activity will decrease.

BOOK REVIEW

The Handbook of Political Fallacies by Jeremy Bentham
Harper & Brothers, 49 East Thirty-third Street, New York 16, New York ($1.60)

Now that so many economists have entered the political arena, they as well as citizens generally should find interesting and useful this exposition of the fallacious arguments used to obstruct or delay reforms and to arm those in authority against their critics. Crane Brinton, with his usual discernment, has provided an introduction.