

- Welcome once again, as MIT professor Paul Samuelson discusses the the current economic scene. This series is produced by Instructional Dynamics Incorporated. This program was recorded February 14th.

- Today I'd like to comment analytically on the economic report of the president. This is a document which has come out annually since the Employment Act of 1946 was passed. It usually comes out at the end of January this year on February first. It consists of two parts, the first and briefest part is the report of the president himself. I cannot remember right now whether it was always the case that the economic report of the president himself was clearly delineated and distinguished from the economic report of his council of economic advisors. But that certainly has been the practice for the last dozen or more years. This report which is signed by the president is in fact not to be construed I think very differently from the economic report which is signed by his council. A report in a sense to him because everybody recognizes that the report by the council, is a governmental document, and it doesn't represent the private opinions of doctor Herbert Stern or doctor William Feldner or doctor Gary Sievers. It represents their position as the spokesman for the administration. And nevertheless it's a good vision because it does give the council of economic advisors, freedom to go into things which it would never be considered part of the professional competence of the president. I have in mind for example that there is an informative chapter in this year's report, annual report of the council of economic advisors on the distribution of income, chapter five. There's no reason why queen Elizabeth of England can't pin her message to the parliament, message from the throne, say anything that the Prime Minister Heath at the present time would write out for her. But it becomes a bit of a charade if she goes in to technical matters and so although there have been previous presidents who really thought that they wrote the economic report of the president and of the council of economic advisors. It's understood that these are official documents written by professional people but reflecting the agreed upon doctrines and policies of the administration. I've commented briefly in overall way in a news week column on this present economic report. I said that mr Nickson's economic report this time, deserves a much better grade than say three years ago when a slump was reached and when a C minus would have been charitable to give to that document as a whole. The reason for that was that it made explicit and implicit predictions which deferred from that of the majority of economists. Those differences were not defended in the report, reading in the lines, between the lines, it seemed as if the heart of Paul McCracken for example then the chairman of the council of economic advisors wasn't really in the overly optimistic forecast that was being made for the year 1971. And grievously did the administration suffer both in terms of morale and in terms of psychology, from that unnecessary bad performance. Well if that was a C minus performance, it seems to me that the report for February 1, 1974 has to be graded distinctly upward, let us say B plus. For one thing and I use this as a term of commendation, it's a very low-keyed report. Both in the president's small section and in the report as a whole. If there was ever any thought, that the electoral majority of the president in which he won 49 states in November 1972, gave him the leeway to pursue a path away from what has become the middle of the road path for American economic policy. We all know that the events subsequent to Watergate have deprived the president a very much discretionary power and his state of the union message showed that in its being on the whole a low-keyed compromising middle of the

road document. And I believe the present economic report of the president is to be commended because it also shows that same moderation. For one thing, it calls a spade a spade, namely it calls a growth recession, a growth recession. It calls an almost recession in effect an almost recession. Whereas the president you will recall in a state of the union message, had said there will not be a recession in the United States. There is no such brazen utterance either in the president's own brief part of the report, nor in the body of the larger report from the council. Because it's a very close close run thing whether a 1974 will or will not go down in the economic history books as the year of genuine recession. It's so close that when secretary of treasury George Shultz, was briefing the press on the budget message which came out a day or two later, there was a certain amount of humor sparring going on. I saw only a film clip sample on one of the network news shows. So I presume that the press must have asked him, "Is there gonna be a recession this year?" and doctor Shultz said, "No there's not going "to be a recession, but I know that you fellas," and am sorry that doctor Shultz got in the position of regarding the press even in a jocular way as the enemies. "But you fellas are gonna call it a recession if you can" and we're gonna say it isn't a recession "if we can, and there is enough," I am not quoting him verbatim now. "There's enough of a semantic ambiguity about "what does constitute a recession, so that "we both have it our way, you will call it a recession, "and unless it's got awful, we will deny "that it's a recession." But what's important is that the outlook is given by the council, and let me tell you where we stand according to the informed professional inside opinion. I correct myself, this is what the council thinks is the appropriate thing in a state document to write. What is implied, I'm reading now from page 28. What is implied by the path ahead, that if the president seems to us the best of feasible ones for the economy. Given the inescapable effects of the energy shortage, there's an increase of about eight percent in the nominal, or money value of G.M.P. From calendar 1973 to 1974. That will be an increase to about one trillion 390 billion. Of this rise, about one percent will be the increase in real output. And so you notice we definitely can look forward to a growth recession. And about seven percent an increase of prices, as measured by the G.M.P deflator. And so we definitely can look forward to a continuation and even extenuation of the price inflation. Changes from calendar 1973 to 1974 are of course significantly influenced by what has already happened in 1973. And hence changes so expressed to not describe an expected path for 1974. though they are implied in any expected path. As for the expected path during 1974, this would leave real output approximately flat. And perhaps declining for an interval in the first half of the year, but would bring a rise by somewhat more than the normal trend rate in the second half. I'll interpret that sentence in a moment. Inflation would be rapid in the early part of the year, mainly as a consequence of energy and food prices. And then subside to rates significantly below those experienced in 1973. Unemployment for the year would average a little above five and a half percent. Well what's being said here is that if we look to the four quarters of 1974 as we should, then in the first quarter, and possibly in the second quarter too, there would be an actual decline in real output. I would say that is a conservative estimate of informed opinion outside of the government. There are a few people who think that output will be declining throughout all the four quarters of the year. I believe that Doctor Summers of the conference board would be such a person. But such people are in the minority, and so although the council of economic advisors is just a shade, a more optimistic, then is the median forecaster among the fashionable forecasters. We can say they do deserve their B plus because they are in the right ballpark. On the other hand for the last half of the year, they say that they will be an increase stronger than trend. It seems to me that that is a possibility but just from considerations of continuity, it would be a bit rash to expect that the last half of the year would average annual rates of real growth of more than four percent because the trend rate for the

American economy is in the neighborhood of four percent. Actually most people think just a bit above that. So here I think the council of economic advisors and the president's economic report is just a bit too optimistic. Now what about inflation, certainly we can agree that inflation will be rapid in the early part of the year. We are now experiencing that, we are not only still experiencing that in the field of energy in the case of fuel prices, in the case of gasoline, and if there was not interference with the free market, we would find even greater increases in those items. But we're also beginning to see food prices rising. The future's markets which are very quick to pick up any changes in trends, were extremely surprised a fortnight ago when the official government report came out and stocks of all the grains and all positions turned out to be even lower than the low expectations of the market with a result that the grains went up, the limit for several days in a row in some cases. We've also had in the middle markets, a contamination one might say from the increase in the price of gold so that the silver which is purely now a speculative market not a market determined by the useful photography and the supply from the mines but by one speculator thinks another speculator will think is gonna happen to the price of silver. That has risen to an all time high indeed it now pays to melt down 90 percent silver coins and convert them into bullion at the present rate. I doubt that they're enough of such coins that are going through that process right now to bring back that speculative bubble in prices. But you're also beginning to have talk that if O.P.E.C can create a successful monopoly among the oil exporting countries, why can't there be a successful monopoly among the other metal companies. What about aluminum, firming up to aluminum price structure by an international cartel. What about firming up the price of copper by an international cartel? I think were even beginning to get gleams of glory that maybe cocoa and coffee and sugar, which have had their cartels in the past, cartels which have broken down, might hopefully again form cartels. Well nobody need expect these particular micro-economic shortages and increase in prices to continue indefinitely. So I think it would be rash in the last part of the year to be projecting the same prejudice increases in prices that we're experiencing at the present time. Nevertheless to say that inflation in the last part of the year will subside to rates significantly below those experienced in 1973, if by that it's meant the average of 1973. It seems to me runs contrary to the evidence and to the testimony of the majority of the forecasters. It runs contrary to that evidence in the same direction the government, this government and am sorry to say, some previous governments have had in the past. Namely good news ahead, bad news just ahead because who could deny it but good news in the form of pie in the sky and a return to normalcy just ahead. Finally it said that unemployment for the year would average a little above five and a half percent. If unemployment in the four quarters averages a little above five and a half percent, that means that unemployment towards the end of the year, will be averaging very near to six percent. And I would think that a safer betting number would be in the neighborhood of five and two thirds percent rather than in the neighborhood of five and a half percent. A small difference perhaps you'll say, but it's precisely that small difference that can mean the difference in a key congressional election. And it's also that difference which represents the difference between good, disinterested, professional forecasters from the outside and what I shall say, are good but necessarily not disinterested forecasters within any government. Now this is their most probable path improbability. But their hasten to say that although there is no other path, which seems as likely to them as this, the spread of what is likely to happen is a very wide one. They also say that this is the path which will be realized provided the policy recommendations in the president's messages to congress and in this economic report are followed. And we seem to be very lucky in America, the path we're gonna have is the path which we ought to have. Because they say that this is the most desired path, in other words the policy is optimally designed.

Now there is a note of humility and I think it is a very important note. Namely that as information changes, the administration is prepared to change its policy. This is what is required of a government by intelligent men, by intelligent administrations, by intelligent congress. As your information pattern changes, you change your optimal behavior. If this be fine-tuning of course, then what we would require is fine tuning. But that puts a pretentious claim to accuracy which no informed modern economist ought to make. And so let's say this is the sensible stabilizing lean against the wind policy. Many people said when the president said there will be no recession in 1974, in a state of the union message. That this was just empty rhetoric, this was one of those horrible examples of King Cnut who is telling the waves not to advance on the shore to his throne, but because of his edict to stand back. Well perhaps that is one way of reading it, and perhaps that was a line designed to draw some applause. Perhaps it was a line designed to gain some temporary assurance for the American people. But I read it in a different way, perhaps I'm an incorrigible optimist. I read that it meant that if necessary, the president would do what was required to keep this growth recession, this bare recession, from snowballing if it showed some signs of doing so into something much worse such as a good old fashioned recession. And I was heartened by this in the same way that I was heartened when in at the end of 1953, General Eisenhower our president Eisenhower then made the statement, that he would throw away the book of Orthodox finance, I'm giving a paraphrase for what it was that he said. If necessary, so that the post Korean recession would not accumulate and develop into a more serious chronic slump or a depression. Or even a more serious recession. I know that any government which has the will to take such opportunistic action if you like, will have the power to do so, and to do so successfully. I might call your attention by the way to another statement which was made in the state of the union message, one that I've commented on already. That the president explicitly said there that he was not gonna listen to the prophets of gloom. But he included in that two camps and the second camp which believes that the best policy ought to be to let 1974 develop into a genuine recession. Perhaps to let all four quarters of 1974, show small negative real growth. Why, well of course in the interest of lasting improvement in the price inflation. The president if he philosophically and scientifically agreed with that as the best diagnosis, is in no position to engage in explicit policies based upon that. Of course he could implicitly by impounding funds, by doing things very quietly, engage himself in part of such a policy. But he doesn't have the political power now to do so. But in any case, he asserted and let's assume that the verbal assertion tells us something about actual intentions. He asserted that he would not be willing to deliberately countenance a slow down or slump or recession in order to fight the inflation despite the advice of those who would urge that. Now what does this mean with respect to fiscal policy? It means an unbalanced budget. The president says it's regretful and most of the unbalance is due to necessitous expenditure but I guess since he stuck with an unbalanced budget, he might as well take the credit that this is indeed what proper policy would require. When we know that six months ahead and nine ahead and twelve months ahead, there's going to be surplus labor force in comparison with the jobs that the American system is gonna be able to give to them. The budget will be just about balanced maybe even a little bit of surplus in terms of the old fashioned full employment budget, if you define as your full employment budget for a percent of unemployment. But one of the most interesting sections in the economic report, is a discussion of what I ought to constitute the level of full employment today. And they give what they actual budget deficit would be let's say now for calendar year 1974, the actual budget surplus or deficit for that year if the president's program is enacted by congress is minus five billion dollar deficit. But if we use the full employment target of four percent, and recalculate what our revenues would be at that level and what

perhaps what a few of our expenditures changes would be, we find that the budget is essentially imbalanced. It has a point two billion dollar surplus and is really not worth talking about. Then since there is some difficulties in the calculation of the four percent unemployment because the revenue is of the American government are affected by the rate of inflation. If you have four percent unemployment but price is behaving the way they gonna behave now. So standardizing for inflation rate, you again have a balanced budget or slight surplus of point three. But with a variable unemployment rate, which is the euphemism and I call your attention to the table on page 31 because it's one of the most interesting developments of recent years. We've known about it below the surface. Those of us who've been able to read between the lines of speeches by the administration and know how the thinking has been going. Realize that silver people inside the administration do not think the four percent is a feasible target. And because there are so many young people in the labor force, and they have a higher propensity to have unemployment because they are so many. Part time women in the labor force and increasing number of those in comparison with earlier periods. If four percent was the proper goal in those earlier periods, then at the present time, a higher unemployment rate and 4.6 percent I believe for 1973 is now the magic number. And on that basis, it looks as if we're going to have a small deficit. I do not say this by way of criticism because if anything it seems to mean this deficit is too small. I would also say that the priorities that are involved in this kind of a deficit with the expenditure program given in the tax program are not my own priorities. And that's why I cannot consciously offer an A minus or an A plus to this report. It's a best a B plus. What about monetary policy? Of course all of us attach importance to money, but some of us attach more importance what they have said. And it's really a very brief passage, it's amazingly brief. I would say amazingly naive. What they say is that in the past, the stock money broadly defined which is M2, which is ordinary currency outside the banks. Ordinary demand checkable deposits. And also time deposits perhaps with some large CD's left out just so we won't get some contamination from regulation too. That has been proportional to amount of nominal G.M.P. In other words, it's had a constant velocity of circulation of money for the last several years. Overall they point toward a myth that there have been some short term swings. The result is that since their optimal policy goal and best expectation is that there ought to be and will be a eight percent increase in money G.M.P for the year, if M2 has a constant velocity then to realize that M2 ought to grow at eight percent. Now my time is just about up but it seems to me that in a recession year this is definitely too low. Because it's very hard to calibrate. You can get some ideas of this if you turn to the table on page 82, what's relationship is between M2 and M1 the monerally defined. But I guess one would have to assume that eight percent on M2 would correspond to something like five or five and a half percent on M1. And it seems to me that if that is a proper average figure over a decade or over several years over a business cycle, then you ought to be exceeding that number in the first onset of the recession. When as you look ahead six months, nine months and twelve months. You find unemployment higher than socially it ought to be. Well there are many good things in this report, I wish I had time to go over with you the discussions of inequality. It is extremely interesting showing there's been some slow progress. But definite progress apparently in the relationship of black earnings to white earnings. Unfortunately there is no similar progress for female earnings relative to male. But as a mitigating circumstance, the report points out that the more and more women are coming into the labor market and on a part time basis without the sustained experience which makes for a higher earnings. It's nice then to be able to give a higher grade to a government document like this because of course we're all in the same spaceship together and we want that pilot to be skillful since we're the passengers who ride with him.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated. 166 East Superior Street, Chicago Illinois 60611.