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- Welcome once again as MIT Professor Paul Samuelson discusses the current economic scene. This series is produced by Instructional Dynamics Incorporated. This program was recorded May 7th.

- This is a very exciting time to be following the course of the American economy. We've had the first quarter numbers, I commented very briefly on them last time. Shortly after the new numbers come out, the way vultures go to carrion, the computer experts begin to grind out the new forecasts based upon the new benchmarks of the new numbers. And so today I can begin to tell you what wasn't available to me at the last recording, how the various forecasters have reacted to the rather surprising new first quarter numbers. All of this reminds us of the wisdom involved in that folk saying, if you must forecast, forecast frequently. I just learned from an article in one of the newspapers that that particular aphorism is attributed to Marcus Nadler. Well, more power to him. I'd rather be changing my mind and not stay wrong, in that sense be right, than to stick with a earlier wrong number. By and large I have to say that the forecasters have not lost their nerve as a result of the surprising and disappointing first quarter numbers. You might have thought that with 5.8% rate of decline in the first quarter and with a worse rate of inflation, that those people who were inclined rather towards believing in a recession, who ordinarily position in that regard without taking into account any oil-break cuts that they would be now feeling more certain about their recession estimate. But if I look at the actual forecast, the new forecast of Albert Summers of the Conference Board. It doesn't appear to me that he is essentially more pessimistic than he was before he knew the first quarter numbers. On the contrary, he's more like the rest of the crowd now than he was previously. I noticed that Chase Econometrics which for once Wasn't on the nose, well nobody was on the nose in the first quarter forecast but it was a bit farther this time from the preliminary commerce estimates than the people I suppose that Chase Econometrics typically watches people like Otto Eckstein and DRI and Alan Greenspan. Well they were just a bit closer this time than Chase Econometrics was. Now that doesn't mean anything of course because it's your batting average over a long time that counts and also, all three that I've just mentioned are very much in the ballpark and particularly in the ballpark in comparison with the general run of forecasters. But it's interesting that Michael Evans in his discussions of the first quarter and what it means for forecasts to come has expressed the opinion that this time the original estimate of the commerce department may simply be wrong. Now it's a mug's game of course, every time your forecast isn't realized for you to say well I'm right and the figures are wrong, dammit. But that is not what I understand to be said here. There's a reasoned argument as to why the figures may be several billion dollars too low. And before we... Disregard that as sort of sour grapes, I want to call your attention to a very interesting phenomenon that's been noticed by people who follow the techniques of forecasting. Very often I'm told this by my colleague Franco Modigliani who is the... First among equals in the, what used to be called the FRB-MIT PENN Model and now is the called I believe the MIT-PENN Social Science Research Council Model. I'm told by him that very often their model isn't exactly right when the first estimates come out. But it's surprising how the first estimates, when they come to be revised, and they almost always are revised, tend usually, not always, to be revised in the direction of what the model said. So it may be that when all this is economic history and when we look back that the third shall be first, and that the first quarter which was surprisingly weak wasn't quite as weak as the preliminary estimates seem to suggest. I wanna report though that if I look at the different models they still... By and large all unchanged, they still by and large cluster around almost no change in the second quarter. On the one hand somebody like Doctor Eckstein of Data Resources Incorporated looks for positive numbers of some significance in the second quarter, the current quarter. And Chase looks for still a very small negative, but you can find the mob pretty much clustered within that same interval. And that's not much different from before. Now what's more important and what I'd like to talk about today because it's what is in the minds of everybody. The experts have not significantly been changing their estimates of inflation in the fourth quarter of the year. Now that's deceptive because there is a slight tendency for them to be edging up as you get nearer and nearer to that date and as you have been disappointed in your price forecast you begin to adjust your next forecast in the direction of the reality you've just experienced. But by and large you will find more people who think that the price inflation will be around 6.5% to 7% in the fourth quarter of the year than you will find who think that price inflation will be double-digit numbers like 10% or 11%, like that which was experienced in the first quarter. Or even than 8% or 9%. So we still have the split between the great... Lay public, the man in the street, the man in Main Street, the man in Wall Street, and the man on Capitol Hill, and on Pennsylvania Avenue. Split between all of them and the experts because there's still prevail throughout the land, an abiding concern about double-digit inflation. And so we have to ask ourselves could it be that this time the heart has reasons that reason doesn't know and that the instinct of the non-economist is more nearly correct. It's that problem that I wanna address myself. Related to it is the question of what we ought to be doing about the situation. And of course the number one question, well there two questions really, and these are both matters of hot debate. First, how much should the rate of growth of the money supply be contrived, engineered or permitted by the Federal Reserve in view of what we can expect ahead? And secondly, what should the budgetary posture be? And in particular, in this last fiscal policy connection, ought there to be some kind of a tax cut? A tax cut in part at least perhaps to counter the weakness that is in the economy. These are all related matters. Before I discuss the policy issue and try to weigh for you the pros and cons and discuss the probabilities and where the bulk of those probabilities lie. I ought to mention that we've had some more numbers since the first quarter numbers came in. In particular we have had the good news that unemployment dropped for the second time in a row. You'll recall it had been four and six tenths percent, that's low for this last business cycle expansion and it had been climbing and it actually took a jump to 5.2% earlier in the year but it came down to 5.1% and now is down to 5.0%. I think there's no doubt that this goin' take a good deal of esteem out of the movement for a tax cut. And so those members of the administration who oppose a tax cut, I'm thinking of people like outgoing Treasury Secretary Shultz will find that the new unemployment numbers provide them with defensive ammunition for their position. The same thing I think will be true of those who are urging upon the Federal Reserve a tight... Money policy. I have in mind here people like the so-called Shadow Open Market Committee which meets at intervals. I don't think they can afford to meet at three-week intervals like the genuine Open Market Committee but since they generally after meeting and consulting all the omens and... Symptoms, come out with the same recommendation, 5.5%, it doesn't really hurt us that we get those recommendations maybe only three months rather than every three weeks. Particularly since the Federal Reserve doesn't particularly seem to follow their recommended policies. While those who think that the money supply must be allowed to grow at 9% or more... Because... The rate of price increase is something which you must ride along with. They will find their argument weakened by the lower unemployment numbers. I know that if you pore over that unemployed... Unemployment number, you can... Argue in different directions, for example part of the drop in the unemployment percentage rate may have been to due to a... Reduction in the labor force, the numbers seeking work, and maybe that reduction in the labor force, those seeking work, has been a little bit more than one would've predicted on the basis of past experience for a period in the business cycle just like the present one. However from the standpoint of pressure on Congress, these niceties don't, I think matter. You have had... Senator Kennedy recommend a tax cut. You've had Senator Mondale of Minnesota recommend a tax cut, now there's not much news in that, these are two liberal senators if they're not both gonna run for the presidency, certainly it must be said that both of them have the presidency in the back of their minds. But more significantly, you've had some noises by speaker Albert, not a flaming liberal, not a left-wing Democrat, speaking in favor of a tax cut. And you've had some similar... Remarks by Senator Mansfield, the majority leader in the Senate in the same direction. Mansfield again is a middle of the road person. And there's even been talk although I will only believe it when I hear it with my own ears that chairman of the House Ways Means Committee, Wilbur Mills was beginning to look with slightly more favor on some kind of tax reduction. Well again, it's one thing if the unemployment numbers had been marching up 5.2%, 5.3%, 5.5%, 5.7% by let's say the middle of the summer. And one could... Expect that by election time, November 1974, they might well be at the dangerous, politically dangerous 6% level. Well that may still happen, but it hasn't yet materialized. Well so, you must factor into the political equation and I may say into the policy, economic equation what's been happening to the unemployment rate. That's point number one. Point number two, we've had new information on businessmans intentions to invest in plant and equipment. I'm referring now to the latest McGrath Hill private survey. This is a very respected survey, very much watched and it interpolates between the official Office of Business Economics SCC governmental survey of businessmans intentions. And this is certainly on the expansionary side. The number now is something like 19% increase in plant and equipment expenditure for the year over the previous year. I seem to recall that the last government figure, which perhaps was only modestly below the previous McGrath Hill figure was more in the range of about 13%. Of course these are money numbers and when you deflate them by the increase in cost of construction, you don't get real increases of this magnitude. But if you were to have businessmen trying to get 19% increase and if they succeeded in getting let's say only 14%, but the shortfall was due to supply reasons then I doubt that the deflator would be so high that you could conclude that there'd been no real increase. Those who are apprehensive about a serious recession and about a dangerous problem of unemployment will not find the new plant and equipment investment figures particularly buttressing their case. Now let me... Go then into the policy debate. First, most people and I mean now most economists are very diverse methodology, a very diverse philosophical and political opinions. I'm not of the two-digit price inflation school. They don't deny that in case of a crop failure, a serious crop failure that we could be off to the races again with respect to food. And they don't deny that labor is restive. So that collective bargaining agreements could begin to escalate in their escalated demands. But when they put all these elements together, they feel that this present time is the spring of our discontent and that if we can just hang on things are gonna get a bit better. For example, a monetarist who believes that the long-run trend of prices is determined primarily by the long-run trend of the money supply... Will find that a 9% trend in the money supply... Which is what we've been having since early 1971 despite what Federal Reserve spokesmen seem to say about their goal. That increase in the money supply would correspond to about a 6% increase in the price level, not the current 11% increase which we've been observing. And so by... Monetarist lines of reasoning when we get over the bulge that results from the cessation of price controls, it's a 6% level to which we'll return. Now of course a monetarist looking at the way the world's been going politically in the last two decades might well be of the opinion that we're losing our Puritan ethic more and more and if 6% price increase is what's indicated by recent behavior since '71, with our increasingly loose moral fiber with respect to the money supply then there may well be an acceleration for the next few years in the rate of growth of money supply and therefore an acceleration of prices beyond 6% but that's in the womb of the future and isn't indicated for the next year or two. Let me, I mentioned to you a very interesting memorandum, actually a speech that was given by Professor Robert J. Gordon of Northwestern University. I think was a speech given before a business group. Well it was a Conference Board group in Chicago. Professor Gordon is one of the ablest young general business cycle economists. He's in his 30s and any of you who have been reading Brookings Papers will see at very frequent periodic intervals discussions by him of how to account for what's been happening to wages and what's been happening to prices. He has recently taken a good hard look at the policy problem. I believe he started out with the view that... There was something to be said for not accommodating... The economy in its expansion in the last half of the year. By a concomitant increase in the money supply at a rate higher than the long-run level. But much to his own surprise, when he came to analyze the consequences of that position, he found himself converted to the opposite viewpoint. Here's how his argument goes: First, he says he cannot find... That the control programs had any particular downward effects upon wages. This is a bit surprising 'cause most of us have thought that the control program if anything had effects upon wages and didn't have effects on prices. But his finding is interesting because it's the opposite of that. It is that prices are 2% or 3% lower today than they would've been without the control program but wages seemed to be about the same given everything else. The result is he feels that prices now that we have gotten rid of the controls are gonna want to get back that 3%. And so for the rest of 1974 and for part of 1975, he has built into his price equation some catch up. This is bad news in a way because it means that the 5% or 6% which is the base-load rate of price increase is going to be delayed because of the catch up period. This is aside from... A bad harvest. He... Does not take that into account in this particular exercise. And so he says now, suppose that the Federal Reserve does what people have been urging upon it. Suppose that out of its concern for double-digit inflation or for that matter, out of a more rational concern perhaps for 7% or 8% or 9% price inflation, it maintains a rather stiff posture with respect to the money supply. What will consequence be? As he works out and here I think I wouldn't myself put the greatest weight as he works out the velocity multipliers that one might use to translate this into real output. This results in a rather anemic expansion in comparison with what most of the forecasters are predicting going into 1975 and what most of the policy goal people are saying is a policy goal. In particular he quotes, as we all do, the Council of Economic Advisor's own policy goal with respect to real output. He says they'll never make it without the tighter... Monetary policy. As a result unemployment will be on the rise. It may be 5% now but if one can believe Gordon's exercise it will be moving up in '75 to 6% and he even can get it up to 6.6% without stretching the pattern of past experience. Now what do you buy for this rather heavy burden? He spells out, he's done that in the Brookings Papers, what the actual human welfare costs are of the increased unemployment. And he says what do you buy? As far as 1974 and 1975, let's say between now and the end of 1975. In Professor Gordon's opinion, and it's an opinion worth listening to, you buy almost nothing. To speak in technical parlance, Professor Gordon believes that the short-run Phillips curve over the next year and a half is practically horizontal. So Arthur Burns is so to speak crucifying mankind, not on a cross of gold but on a cross of a severely limited rate of growth of the money supply with the effect that if you work out the cost and benefit equation there are very few benefits, almost no benefits on the side of inflation, you're gonna get just the increase, the improvement, the abatement in inflation that you were gonna get anyway. But you do get a tremendous loss in real output. Now what are we to think about this? First. I believe that I would want to augment his analysis by analysis of what happens after 1975 because I suppose we would all agree that the initial conditions that you leave for in 1976 are a bit different under one scenario of Gordon, the tight money scenario as against the one which he now advocates which is the accommodating money supply. That's point number one. Point number two, suppose somebody says well if you file this philosophy every time the economy is weak, this is a built-in recipe for secular inflation. I think Professor Gordon would answer in the following way, he would say we've had a once and for all increase in prices due to the OPEC oil monopoly, due to the crop failures, and that it is a better part of wisdom in a mixed economy when you have an exogenously produced jump upward in prices to a new plateau, to a new trend base. The Federal Reserve in that case should be accommodating rather than to try to roll back those particular prices. Now one wants always to look for the weaknesses in any analysis, I think that I would conclude the following. First I think we must realize the imprecision of any econometric estimates. So that although I had no quarrel with Professor Gordon's mean values and I share his concern that you won't do much about inflation but you will do something about creating stagnation, I think that there is a much wider dispersion around those means than most laypeople realize and even than some econometricians realize and if I were Professor Gordon I would emphasize that fact. Secondly I don't have very much confidence in those stability of those short-run money multipliers and I think that the economy could have greater underlying strength than is indicated in the Monte Carlo simulation exercise by Professor Gordon. Nevertheless, it is a reasoned argument which we should ponder over and which we would neglect to our peril.

- If you have any comments or questions for Professor Samuelson--