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Instructor: Welcome once again as MIT professor Paul Samuelson discusses the current economic scene. This series is produced by Instructional Dynamics Incorporated.

Samuelson: There is a great deal to discuss right now about current economic developments. We've had now all of the presidential State of the Union and budget messages. We've had the economic report of the president. We've had a complete revision of the national income accounts and we have had in recent weeks a very surprising drop in the rate of unemployment. So, this is a good time to take stock and see where we are in the recovery from the recession of 1973, 1975 or 1974, 1975. The recovery in the states has now become apparent to even the doubters. It occurred before the middle of 1975, perhaps in April, perhaps in March will be the dating by the economic historians of the future. It is still ahead of recovery in the other principal countries although in talking just recently to an economist from one of the largest French Corporations I learned that the French economy in his view also very soon after mid year in fact had touched bottom and was on its way up. The story is somewhat to say my think for Germany. And for some of the other countries in Western Europe. But with respect to Japan, an important part of the world international trade picture, the story is a bit more complicated. Japan grew in 1975, it didn't grow though as much as had been expected and really for the Japanese the calibration of what you call an expansion what you call a recession, what you call a growth recession is all important. And what we have to say, that although the Japanese are now growing they are growing at a very low rate compared to what they themselves consider to be the absolutely minimal necessary amount and therefore, of all the countries in terms of what it's been used to. Japan is still in one of the worst situations. You would think from all that I've been saying that the problem of forecasting for this next year for 1976 would be easy. That the signals are all green for go. And in a sense that's true. It's never easy to forecast a modern economy. But some periods are harder than others. And usually in the early part of an economic expansion you are in an easier period than at any other time. Therefore, I don't think it's very difficult to make a bet that 41976 the real GMP will grow. Nor, for that matter if you wanna push your risk a little bit, to say and also 41977. However, for reasons which I'll discuss in a moment it becomes a bit more difficult to make a prediction about the third year of the recovery than about the first and second year of recovery. This is quite aside from the fact that it's always more difficult to predict with precision 20 months ahead as against 10 months ahead or as against five months ahead. The important problem is not whether we are going to grow but just how fast it is that in fact we are likely to grow. Every business decision, every success, in guessing what's gonna happen with interest rate or what's gonna happen in the stock market must sensitively depend upon where you believe the quantitative positive growth will be. And that's the general subject which I want to discuss today. First, a brief word about the revisions of the gross national product accounts. These came early in the calendar year. They were promised us sometime ago but were delayed, perhaps there were a few complications that had not been anticipated by the Department of Business Economics in the Department of Commerce. By and large, to an economist the revisions are extremely interesting to a non economist you nearly have to say that they pretty much conform the previous pattern. There are some differences in definition, there are some differences in factual findings. But by and large, it's only to a specialist that these differences are important.

As I recall, the growth rate in the third quarter of the year was marked down a bit from over 13% to 12% well that's in the right direction in terms of what instinct told us would probably be the revisions. And it's in the right direction in that the economy has no need for any add on when you're already at 12% and it's better for the health of the recovery than it had been 12% than not be 14%. In addition, it turns out that the recession wasn't quite as deep once the figures were revised as had earlier been thought. Nevertheless, the revisions are not large enough to wipe out the recession as threatened to be the case on some of the past revisions of figures with respect to very minor past recessions. Final demand, that is gross national product demand purged of inventory, speed ups, or slow downs has been remarkably steady even from the first quarter of 1975 the trough quarter of the recession. It's been of the order magnitude of 3%, 4%, 5% per annum. In real terms. And even in that 12% prodigious sprint third quarter it was only that order of magnitude. The fourth quarter is reassuring to learn came in terms of final demand as a little bit better than the third quarter, but the overall figures under revision are now as I recall something more than 5% which taken by itself is a bit on the disappointing side. The consensus forecasters I am referring now to towns in Greenspan to chase Chase Econometrics to DRI of Dr. Otto equip. The Wharton Model. Those generally still cluster for the fourth quarters of 1976 much too closely in terms of the actual dispersion which is intrinsic in the data themselves and in our ability to forecast. The lowest numbers that I know of are monetarist numbers by the Citybank. These average for the fourth quarters, I don't have the, the forecast in it's detail right in front of me and I speak from pretty accurate memory. These average something over 4%, in fact, you'd only have to remember four and four. 4% on the rate of real growth or call it four and a quarter if you'd like, four and a half, and something a bit above 4% on the rate price increase. The inflation estimate implicit in this Citybank monetarist forecast is also about as low as any number in my collection, of numbers from people who are worth following in terms of their past batting averages. You could always call the public press for somebody who says that next year we're gonna have steady prices. But that fellow has never been right in recorded history. And why should we give any particular credence to him. Similarly, you and I know people who are crying the wolf of two digit price inflation for next month or next quarter. But again, are these people with any kind of replicable verifiable batting average have been worth listening to in the past and the answer is generally not. The consensus forecasters cluster rather much around 5.5%. In fact if you will take 5.5% real growth and put 1.5% on either side of that you will be able to catch in that corral practically all of the consensus of forecasters. The same thing is true about their price inflation forecast except that it isn't five and half and five and half you probably would take five and a half and six and then if you put a spread of a couple of percent on either side of that you will catch most of the consensus forecasters. Now, the exceptions are interesting. Hard cases make bad law. Somebody once perhaps foolishly said. But it's an exceptional forecast and it'd make for good journalism and the interesting testing of the pudding. Surprisingly, somebody like Walter Heller, is on the optimistic side. Walter Heller, in cooperation with George Perry of the Brooklyn's Institution, Walter Helle of course, is the former chairman of the Kennedy Council of Economic Advisers and the Johnson Council who is regent's professor at the University of Minnesota. He believes that the system under the scenario he thinks most likely for policy is going to grow at about 7% so that's five and a half plus my one and half. On the other hand we have the Citibank, which believes in, only a bit above 4%. The work model which is anything but a monetarist model or a simple monetarist model is also on the somewhat restrained and pessimistic side but not as pessimistic as the as the Citibank The government itself is right there in the middle with the consensus forecasters if we use the economic rapport of the president and the implicit and explicit numbers that are involved in the budget estimates. You know that the budget estimates have always had in them an official government forecast of what was gonna happen to GMP in real terms and in the price level because you can't make an estimate of the revenue which will be collected under our federal corporate income tax and personal income tax without having such data. However, in the past, now happily gained to be the distant past we were never told what those implicit forecasts were, you had to, try to infer from the revenue estimates what they must have been assuming. There was such secretiveness in the treasury at one time or another they wouldn't even tell you what their methods were, whether they used least-squares which is secrecy carried to excessive degree. Well, the last two or perhaps three administrations we have been told explicitly and I do not find any fault with the current administration as I'd have to find with some past administrations including democratic administrations with the openness with which they give their particular forecasts. The government forecast as I say, although you could imagine there is often a temptation for an administration to gloss over bad news and to kind of juice up good news. This time is right there in with the consensus forecasters. The only gloss being put on the data when I looked at a recent round up was that I found that if you look ahead for 1977 last part of 1978 the government forecast suddenly drops its unemployment number to 6.9%, whereas other forecasters are about in the same ballpark with respect to real growth and productivity and everything else, are just a shade over 7% and almost looks as if somebody said well, since 6.9% can be defended as well as seven and since it sounds much better because it takes you out of those awful high numbers which uninformed laypeople will react to adversely why don't we call it 6.9% rather than 7%, while that'd be a sin, I think we have to regard that as a very venial sin. The anomaly which comes out from my discussion of the Heller forecast is that although Heller is at least 1% more optimistic than the govern forecast and I believe that's actually an understatement, as far as as his positivistic betting odds as to what's gonna happen, Heller thinks that the policy recommendations of the government are too conservative. Now, part of the paradox or contradiction disappears when I tell you that Heller's positivistic forecast like the positivistic forecast of all the consensus forecasters second guesses the president's recommendations. Nobody, who is really betting real money believes that the administration believes that its recommendations will materialize but it's aside from that. Walter Heller as I understand it wants a more expansionary monetary policy and a more expansionary fiscal policy. Then he thinks the second guessing of the president by congress is going to bring us and this even though he is already optimistic in comparison with a lot of other forecasters. Now why is this? Well, it's a matter of targets, it's a matter of value judgements and not just of scientific positivistic judgments. People are divided. I mean policy recommended are divided as to what would be the desirable rate of real growth of the economy for the four quarters of 76. To illustrate I have been at meetings and I have read speeches by people like Henry Kaufman and people lik Walter Heller. Now, Henry Kaufman is much more pessimistic if that's the right adjective to use, in his estimates of what will be the actual rate of expansion of the economy. Henry Kaufman is a partner in Solomon Brothers, He's an expert on the money market. He's a man who has been worth listening to in the past, and who is very much listened to at the present time. And when he says that the interest rates still have a way to go down let's say at a year end speech and will reach bottom only sometime early say, in the spring of 1976, that is premised upon a certain degree of weakness in the housing market, which he foresees, which perhaps is greater than the weakness in the housing market which is foreseen by Heller. The same with respect to business loans. Now, the paradox if you wish to call it that is that Henry Kaufman who thinks the economy is weaker than Walter Heller is in favor of less fiscal monetary stimulus than Walter Heller is in favor of. And the explantation for that has to do with the cost benefit value judgments of the two men how much Heller considers short term high unemployment to be in terms of cost of human suffering and how important Henry Kaufman thinks that rebuilding of liquidity and altering of inflationary expectations is in the money market in comparison with these other matters. And I aught not to spend very much of my time, on this tape in boring you with my particular valued judgments and my way of resolving this matter, but for for orientation I aught to tell you about where I stand. I testified some time ago and I don't really have reason to change that testimony that taking other things into consideration I thought that in this first year and a half of the recovery we aught to aim at real growth of about 7% and augtha to be seriously concerned as we fall below 7%. Now, for that view I have been denounced as a conservative. Some of you may have seen Economic Diary in Business Week a fortnight ago or so, and there is a picture of me a likeness I fear. And it says that Samuelson is turning conservative and some Keynesians are asking themselves who needs Samuelson etc. That's the kind of publicity which hurts. It's like having somebody put up your picture in the post office. What is establishable, I don't know want to really criticize that criticism is that I am more conservative in my target than somebody like professor James Tobin a very good economist at Yale University, a good friend of mine, a person whom I respect. He thinks if I understand him correctly and I think I do, that we augtha to be aiming at about 10.5% rate of real growth, in these early recovery quarters. He thinks that this will not have a substantial upward effect upon the rate of price increase and there is a scientific difference of opinion between him and me. I think there is a risk of a velocity of growth effect upon the price level which he thinks is smaller than I do. He may be right. I may be right. But in addition he would disregard the increase in prices if it came about due to this factor or any other factor. And I'm a little bit different in this regard. It's not that I in my ultimate social welfare function put a penalty on inflation as such and consider an increase in the rate of inflation as such as bad as an increase in the rate of unemployment but I believe that in the feasibility, of influencing policy and periods to come that the system will pay very heavily for any worsening of inflation which takes pace right now. You may say that I'm departing from my role as economic, economist sage and I'm pretending to be a tactician sage, well I wouldn't want to make too much pretense that I am any particular political savvy that others don't have but, every economist must form a judgment in these matters and professor Tobin forms one judgment and I form another. 10.5% Tobin, 7% Samuelson, Walter Heller I understand from a recent testimony in Washington and another meeting there he is for about 8.5%. Well, My 7% is higher than that rate which many, maybe the majority of the economic experts in fact favor. I believe you can make sense of federal reserve policy and doctor Arthur Burn's recent changing of the lower limit for the target zone, for rate of growth and the money supply of M1 from 5% to 4.5%. In the following terms namely that Doctor Alan Greenspan at the Council of Economic Advisors Dr. Arthur Burns, believe along with Henry Kaufman that the desirable rate of real growth in these first recovery years is a lot lower than the Tobins, Hellers and Samuelson's believe And there are other economists, I won't name them, who believe this even more to the point where they don't find that there is any useful purpose satisfied by announcing this belief. It is their private belief. And it guides their policy recommendations and makes sense of their predictions. But it will be misunderstood they feel and will be inflammatory and there is no need for them to state that matter. I only emphasize this to indicate that the difference of opinion about objective facts are not as great as the differences of opinion about value judgments and what to happen. Now, I haven't very much time left, I aught to address myself to one new doctrine in economics which is a matter for current discussion. I associated with the name primarily of Alan Greenspan the chairman of the Council of Economic Advisors and perhaps President Ford's primary and chief economic advisor but I associated in a degree but in a lesser degree also with governor Arthur Burns of the federal reserve. In the Greenspan version it goes something like this Change in theory may have been right in its day but probably even in its day it was oversimplified. And in any case in our day it needs to be modified. According to oversimplified gains in theory and I'm giving a rough paraphrase in quote of the new doctrine, the more expansion you have the more in fiscal policy and monetary policy, the greater will be the total effect on GMP expansion. You'll have a secondary effect which reinforces the primary effect. The bigger the primary effect the bigger its contribution to the total effect. But in addition, you get a full secondary effect and maybe according to the simplified Keynesians doctrines some pass through on an amplified basis. Now, Mr. Greenspan contrasts his view which is in a way that more is less. That if you expand by more instead of getting more spending you simply create in a predictable fashion, in a determinable fashion a deterioration of expectations on the part of private spenders and therefore, an extra dollar of fiscal stimulus or monetary stimulus instead of resulting in two dollars or three dollars extra of GMP effect it results in minus a dollar and a half or so of private spending with the result that plus one minus one and a half gives you a minus one and a half and the effect of that is directly and perhaps with some secondary amplification a reduction in GMP. What evidence is there for this view? I've tried to study the economic record of the quarter since Mr. Greenspan first quoted this theory but I've also tried to do it against the background of history and since my time is short I have to be very brief and say that the factual pattern and in particular the residuals of what needs to be explained from the ordinary monetaristic theories and post Keynesians theories have not been in the direction of lending credence to either Greenspan or Burn's versions of this doctrine. Now this is not to say that the University of Michigan findings are wrong when they claim that an increase in the rate of inflation tends other things being equal, to increase the savings ratio, and tends to have some adverse effects upon plant, equip and investment plans and so forth. That relationships can be true without it yet being the case that all the Keynesian multipliers go negative rather than positive. One has to work out as I've done the actual numerical values that are plausible for these relationships. When I said plausible I don't mean in a fine tuning basis but using deep judgments in the matter and so, what I think we really have here is not some new valuable finding about positivistic economics worth exploring further although everything is worth exploring further, but rather a reflection of the underlying valued judgements which Mr. Greenspan is very candid and having and which I think governor Burns has shown himself to have in a long and very candid lifetime of making clear just what it is he does stand for and what it is he disapproves of.

Narrator: If you have any comments or questions fro professor Samuelson address them to Instructional Dynamics Incorporated 450 East Ohio Street, Chicago Illinois 60611.