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PROCEEDINGS JUNE 1958

AT THE

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MAINE

"THE STATE OF THE ECONOMY"

Himy B. Kirshen  
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Pouring over the already extensive literature on the current business contraction, now commonly known as a recession reminds one of the Great Depression of the 1930's. Not of course in severity but in the range between pessimism and optimism. Also there seems to have been little improvement in political speeches. One would have thought that a bit of sophistication might have followed the experience of the last great depression, but alas, our President and some leading businessmen still feel it is essential to reassure, to express great faith in the future, to allay fear and to take the public by the hand. There is something about a business downturn that turns us into a gigantic nursery school. Possibly I exaggerate. But I do recall predictions for recovery slated for last March. Something is always around the corner. And I have read reports of companies exhorting the consumer to buy while they are diligently cutting their work force and planning a lower capital investment for the next year. At the same time many have a sincere desire to keep the government out of an active role in economic affairs and yet the cumulative effect of what is happening will inevitably bring in government in one way or another. Indeed this seems like a mixed up world. A moratorium on living speeches, including this one, might be a great help.

Now the "State of the Economy" is partly a question of fact. There can be no doubt that, in general, the economy is not booming, nor is it even mildly prosperous. To state this is not to criticize anyone. No one is particularly to blame. No one need have guilt feelings. No one is a culprit. And if, for political purposes a scape goat is needed I suggest a stuffed owl. The bird is supposed to be wise but being stuffed can continue to look wise and yet be indifferent to criticism.

But to get back to the "facts" of the case, Unemployment is around  $7\frac{1}{2}$  per cent of the total labor force and this is higher than in the 1949 ( $5\frac{1}{2}\%$ ) and 1954 (5%) recessions. It is the largest degree of unemployment since the 1930's when it was about 20 per cent. More workers are on a part-time basis and many work fewer hours so wage payments have declined. Obviously profits are down. Capital investment is down. Inventories are being used up. Recently an article in Business Week (May 31, 1958) portrayed the consequences to the white collar worker and the business executive. When the cutback reaches here we are beyond a "mild" readjustment. I need only mention the action of State Legislatures imbued with "economy." It is as if nothing were learned in the 1930's. And this is basically because there is a widespread opinion that we now have effective defenses against a downturn. Indeed we do, compared with the incredible naivete of the early 30's. We have unemployment compensation, old age annuities, better Economic knowledge, more effective fiscal tools, and a stronger Federal Reserve System.

The fact still remains that while our unemployment compensation prevents privation it does not and cannot, even if more adequate than at present, simulate the Economy for further growth. And there is much evidence that Federal Reserve monetary policy is better as a brake than as a stimulant.

As reported by the Federal Reserve Bulletin of May, 1958, let me give a brief picture of the unemployed. Something over 5,000,000 were reported

unemployed in Agril. Of these  $3\frac{1}{2}$  million were men. And of the total unemployed about  $3\frac{1}{2}$  million are covered by unemployment compensation although more and more of these have exhausted their benefits and more and more have been unemployed for 15 weeks or over. Average benefits are about \$30.50 a week. This compares with weekly manufacturing earnings of around \$80. The discrepancy is more than obvious. Most of the unemployed are men between the ages of 20 to 34. The largest percentage of the unemployed are in mining, construction, and manufacturing, particularly in the manufacture of durable goods. In these areas the unemployment rate has run over 10 per cent. About 70 per cent of all unemployment has come from manufacturing. In the automobile industry the rate has been 30 per cent. This most certainly explains the kind of collective bargaining carried on between the unions and the big three in the industry. Since the men are now working without a contract Walter Reuther the AUIW President must be betting on a recovery within a relatively short time. Either that or he has fond hopes of strict discipline in the union. Possibly Reuther is following the activity in the Stock Markets.

The three most important areas from which come the substance for the Economy: Consumption, Business and Government spending are all unstable economic factors. Business spending has fallen faster than consumption spending. And although the Federal budget is high, it is unstable. This seems to be an inevitable political fact as inevitable as the necessity of reducing business expenditures when profits seem unlikely. This is the way we work. Congress, for many reasons, can cut the budget or increase it but what is going to happen can be for reasons other than whether the decision is likely to have an impact on the total economy. Foreign aid is cut or increased for as many non-economic reasons as the reverse. And I am not advising the Congress to listen only to Economic arguments but we must recognize that government spending has an impact on the Economy and that over the years government influence has been growing . . . wars, depressions and the increase in the public welfare. In the final result Business and Consumption spending are more likely to follow economic factors than will governments.

There is a decreasing call for a balanced budget in times like these. Indeed nothing unbalances budgets more than an economic downturn. One thing we have learned; a deficit is lived with even if reluctantly, at least on the Federal level.

Predicting government revenues during a downturn is a hazardous business. Even those Economists who act as Government Advisors feel the need of fitting the facts to the need of a little optimism. I shall read to you a discussion between Dr. Saulnier, chairman of the Council of Economic Advisors and Senator Douglas of Illinois: (Page 9 of Hearings on the Economic Report of the President, January 27, 1958)

Senator DOUGLAS. I am trying to bring out this: Aren't you really being too optimistic in your belief that revenues are going to hold up? To the degree that you are, receipts from excise taxes will be down? And while it is true that the income tax and corporation tax payments will in the main be based on calendar 1957, which is over with, there will be some payments on current receipts, current income.

I am sure your faces would be quite red if on the 1st of July, the 6th or 7th of July, instead of a deficit of 400 million, which you endorse, which you are not endorsing, you have a deficit of over a billion or 2 billion; that would be quite an error.

I want to say if your face is too red on this point \_\_\_\_\_  
Mr. SAULNIER. If my face is red at that time, sir, it will be red not because of an unrealized statistical estimate, but rather because our economy has not shown the recovery which I think it will.

Senator DOUGLAS. Well, in all these things it is very important not to let hope control judgment too much, just as we can err with excessive pessimism, so you can err with excessive optimism.

I suppose the party in power always errs with excessive optimism; the party out of power tends to err with excessive pessimism. But the economists are supposed to move without optimism or pessimism, but with cold realism.

I am wondering whether you have not adulterated your cold realism with a good shot of optimism.

That is all, Mr. Chairman.

Mr. SAULNIER. One of the comforting implications of optimism in these matters is that by and large, optimism about the future encourages one to do the things that will help make the optimistic expectation come true.

Senator DOUGLAS. In other words, by blowing on the thermometer, you raise the temperature.

Mr. SAULNIER. Not at all, sir. These questions about revenues to be raised 18 months ahead are matters about which there can be fairly wide differences of opinion. All I am saying is that when you make your judgment as to what figure seems to you best within that range, that if you do lean toward the optimistic view, you may be encouraged in certain respects to do things that will help your optimism to be realized.

Now I wish to read from a comment in Business Week, May 24, 1958, page 23.

Second, the budget deficit is growing, even without a tax cut. Receipts fell sharply in March and April and are now running behind fiscal 1957 for the first time. Spending is rising. The outlook is for a \$3-billion deficit in the current year, with an \$8-billion to \$10-billion deficit possible next year.

No criticism is meant here. Prediction in Economic affairs is as difficult as finding a cure for the common cold. And yet predict we must if we wish to make decisions. To wait until knowledge is exact and prediction perfect is to wait for the millennium and a utopia none of us shall ever see. What we can predict, however, is that if consumer and business spending continue to decline this will be cumulative and deepen the downturn. If the Federal defense spending were not available the downturn could be like the 1930's. I see no reason why one should apologize for high defense spending. We live in this kind of a world and the Economy must operate within it. The Economy is enmeshed in it and a divorce is hardly likely in the visible future. While we watch Russia growing faster we must not forget that Russia too devotes a substantial part of her resources to military hardware and services. And if she does not have the kind of unemployment we do it is because we simply do not expect to run our Economy as she does. This does not mean that we should ignore the weakening effects of an economic contraction. It only means that we must deal with our kind of Economic problem within our institutional set-up and these institutions are flexible enough to stand the policies essential to recovery.

Given the evidence of our history I think it is high time for every one to agree that recessions are part and parcel of our economic system. The unparalleled economic development after World War II was not in a straight line.

The relatively mild recession of 1949 and 1953 encouraged an optimism akin to that of the 1920's and blinded us to the hard fact that it is still possible to have severe contractions, if not of the 1930 variety, then still serious enough to drop the easy attitude of "wait and see." And in this process of more sophistication the real problem is not whether we can eliminate economic contractions but mostly on what level can we afford the effects of contraction? We are inclined to let the contraction proceed farther than essential. Beseet by fears of inflation because of the continuing rise in prices since World War II we now tend to refuse to worry enough about deflation. This is quite understandable and reflects itself in the conflicts of our political life and tends to separate those who claim to be conservative from those who are liberal. Such distinctions follow from the inadequacy of our economic controls and the inability to agree on measures of economic protection. And this comes from differing social and economic values. Take a simple thing like the recent Federal Law extending coverage for those whose unemployment benefits have been exhausted. Since the 1930's the proportion of unemployment compensation to a man's actual wages has declined. Originally it was supposed to be about one-half. It is closer to 37 per cent and in some States less than that. If the real objective was to place a floor, even a low one, under a man's income then the outcome would be simple. But it is not that simple. The recently passed law allows States to borrow funds to extend coverage to workers who have exhausted their benefits. Why borrow rather than allow outright compensation if that might help, not only the worker but also shore up consumer's income.

Well, at the moment, we happen to be in a period of "States Rights" and it is feared that outright Federal funds might lead to a permanent increase in coverage within each of the States. This could add to employers contributions and add to the cost of doing business. We must remember that most States, in an effort to attract industry usually advertises how low is their unemployment compensation tax. Attracting industry is a laudable enterprise but it conflicts with what ought to be done during a recession period to support unemployed workers, not only on humanitarian grounds, but chiefly on economic ones. In short, it is not unusual for society to injure part of itself in order to preserve some other value, usually non-economic in nature. In my opinion the present law has little to commend it as an anti-recession measure.

I might emphasize another area. The fear of inflation, and this is real although exaggerated and has led to a hesitancy that has permitted this recession to become more severe than it might otherwise be, or at the least, it has more or less led us to fiddle while the house was burning on the theory that the burning might stop by itself. I am exaggerating the old theory only to bring out a point. We might adopt the theory recently put forward by Professor Galbraith of Harvard University that it is time to forget stressing private production and shift economic resources to public needs, like schools, for instance. This shift would require a shift in attitude unlikely to occur in the reasonable future and unlikely to occur even if the contraction became a bit deeper. Such a proposal is more likely to be labelled "socialism" and let it go at that. Not that we do not spend what appears a great deal on schools, roads, public buildings and so on, but that we are not likely to spend enough significantly to shift and allocate our resources away from the private capital investment market. I am not going to discuss the merits of Professor Galbraith's thesis. I merely mention it here because I think his idea was born of our current problem of alternating periods of prosperity and depression (or recession if you do not like the word "depression", we can reserve that nasty word for the more severe types of contraction).

The State of the Economy, then, is partly a matter of economic facts and how accurate they are. It is partly a matter of how one reacts to the facts and this to a certain extent is political in nature. But what is political in nature is partly a "State of Mind", a concern with fears and values people hold as when Legislatures or a Congress should and should not act, as when monetary policy or fiscal policy should take over or whether humanitarian motives should determine the measures adopted or how strong is a fear of governmental action. In a democratic country such conflicting views and values are inevitable until a crisis develops and such a crisis has not yet come to pass.

I think that my friend and former colleague at Maine, now at Michigan State University and soon to be a colleague again, Dr. Pao Cheng put the issue neatly when he recently stated:

"With nearly everyone pondering the question of how much the Federal Government should do, I would suggest that it do more than whatever was felt necessary for a mild recession and less than whatever was felt necessary for a major depression. How much is that? I leave it to the ones who fear inflation the most to set the lower limit and the stagnationists to set the upper limit."

My own view is in agreement. I would add, however, this. Should the unemployment rate not go below 6 per cent in another month both excise and income taxes should be reduced. Had this been done some time ago it would have been better. I think the recovery this time will be slower than in the recessions of 1949 and 1953. There is also a need of extending unemployment benefits and extending the time for them. I would further express the need of stabilizing government spending in the sense that government take account of the periods of contraction to expand spending and be careful not to reduce spending too abruptly in more prosperous times. The fact remains that government spending, like business spending has an influence on the economy we cannot ignore. I really would not expect many to be impressed by this argument because what one wants governments to do does not necessarily coincide with the alternating periods of the business cycle. Sometimes a doctor's advice is only for the record and leaves the patient unimpressed.

The forces for growth in this country are too strong to end on a note of dire pessimism. And those that want to "wait and see" what happens before doing anything unusual are not unreasonable people. And in the final accounting they can point to successes too by pointing to 1949 and 1953. Of course the great depression of the 1930's was different. Indeed it was. My only note of pessimism is that the "wait and see" attitude is hazardous and smug. I still belong to the school that thinks a major depression is a possibility and that we rely too much on the weapons forged in the 1930's and that we ignore whatever economic knowledge we have.

The nature of this recession is such that I fail to be impressed with every newspaper report of an upturn here and there. To seize upon any bit of good news is natural but none of the reports so far suggest anything of any real significance. The losses to be recovered by the depth of this contraction will need more than a few bright spots. The patient will recover, of course, but he has been in bed longer than was necessary. The basic theme of this talk is that we have every reason to be proud of our wonderful productive capacity and our unbounded faith in the future but we have no right to be complacent. Although 1957 was considered a prosperous year as a whole and the total value of all goods and services increased 5 per cent real income, that is, actual production,

increased 2 per cent but so did population and that means that our per capita wealth remained about the same. With further increase in population for this year and the years following you might appreciate better how far one can fall behind in real income during a recession if left to what is called the natural forces of recovery rather than the intelligent application of existing knowledge.