Economic Prospects
in the
U.S.A.

by

Seymour E. Harris

Professor of Economics

Harvard University

SEYMOUR E. HARRIS

This article has been kindly contributed to "Review" at our request by one of the foremost of American authorities. It deals with a subject of the utmost importance to America and the rest of the free world, namely: Will there be a serious recession, or worse, a depression in the United States within the next few years? The author, Seymour E. Harris, who holds the high scholastic post of Professor of Economics at Harvard University, attempts to answer this critical question.

* * * *

IT is a long time since the United States has had a genuine depression. Indeed, in 1937-38, there was a substantial recession; but it was short-lived, and in 1938 output was down less than 10 per cent.; and in 1948-49, a moderate recession occurred. But in 1949, the Gross National Product was almost exactly equal to that for 1948; and even before the Korean War, a recovery was evident.

This country has become so accustomed to prosperity that there is a school that seems to believe depressions are a phenomenon of the past. For example, Dr. Woytinsky, a noted statistician with an unusually good forecasting record, writing in the New Leader, reassured the American public that following a programme of demilitarization, tax reduction and pent-up demand would solve our problems. I am afraid that his analogy with 1946-50 does not hold. There is very little pent-up demand. Thus, the American public has been building homes for years in excess of the rise of new families. In the post-war period through 1952, the number of cars purchased reached 29 millions, and the number of cars in use rose to 44 millions at the end of 1952, a rise of 50 per cent. over the best pre-war years, and there were almost twice the number of cars on the road as at the end of the war. It cannot be expected that either housing or automobiles will continue to play the crucial part in offsetting declines in other segments of the economy, e.g., military or soft goods, as in the past. That the average life of a car is now 14 years, as compared to 10 years just prior to the war and 7 years in the late twenties, strengthens the force of this contention.

HOUSING DEMAND

Housing demand, as has been noted, is also likely to play a reduced part. One reason is that the number of families doubled up has declined by about one half since 1947. This process of establishing homes by those previously doubled up contributed substantially to the annual post-war demand of 1.5 million units—now reduced to 900,000 units in 1952. The Census estimate for 1953-55 is 750,000 units per year; but this is on the assumption of continued high employment and income. A substantial drop of income not only will not be offset by a rise in housing and automobile outlays; but actually a decline in expenditures for these items would tend to accelerate the decline. That housing outlays are primarily for adding to the supply and not for replacement makes housing outlays very sensitive to business conditions. *In fact, the greater part played by durable goods of all kinds is a factor tending to strengthen the cyclical vulnerability of the economy.*

While we are on the subject of major determinants of total purchases and particularly those subject to large fluctuations, we should consider briefly private domestic investment and the net export balance. An excess of investment over savings available to business tends to stimulate the economy; and similarly with an excess of exports (inclusive of services) over imports.

PRIVATE INVESTMENT

It is important to assess the future of investment; for the health of our economy depends in no small degree upon the level of investment and its relation to savings. Personal savings have tended to be high in 1951 and 1952—an average $18 billion as compared with an average of less than $9 billion in 1946-50—8 per cent. of disposable income (after personal taxes) in 1951 and 1952 and 4½ per cent. in 1946-50.

These large savings point to possible difficulties. Consider also our investment history of the last 7 years, with business plant increasing by around 50 per cent. in real terms and a dollar of investment becoming increasingly effective despite the general loss of purchasing power of the dollar. The United States has experienced the biggest investment boom of its history, not excluding that of the twenties. (Lord Keynes never agreed that the speculation of the twenties was in fact a substantial *investment* boom).

Is it likely that investment will continue at the rate of the last 7 *years?* I have serious doubts. I say that, despite the results of the famous McGraw-Hill forecasts of investments. Their latest (just out) shows planned capacity in manufacturing at 238 in 1956 (204 in 1952, 218 in 1953), with 1939 at 100. The McGraw-Hill forecast of 203 for 1952 had actually been proved remarkably accurate (204). Even this forecast shows an annual rise much smaller than in the last few years. Again, basing itself on a questionnaire addressed to large corporations, the U.S. Department of Commerce for the first time has dared to estimate several years ahead expenditures for plant and equipment for *all* business firms. The results are interesting.

"These large companies project capital outlays in 1954 and 1955 at 85 per cent. and 80 per cent., respectively, of 1952 volume, when the returns are weighted by industry. This is a relatively small drop for periods far ahead, but again there *must be a caution that this rather favourable pattern is based upon an assumption of continuing high general business activity.*"

I am not inclined to put too much confidence in these forecasts, for the simple reason that plans would be adjusted as business conditions change. This seems to be a tenable position even though business tends to plan for longer periods than in the past, and hence repudiation of plans encounters greater opposition. It would be interesting to speculate what the 1929 plans for 1930-32 would have been as compared with actual results.

With consumption outlays relatively stable, the brunt of the responsibility for maintaining stable conditions rests upon investment. (Though note that, in the years 1947 to 1952, the ratio of consumption expenditures to expenditure income after taxes was in successive years: 97.7, 94.4, 96.4, 94.5, 92.4, 92.5). Investment played a crucial part in the post-war period. In the years 1946-52, gross private domestic investment totalled $295 billion; but business savings amounted only to $194 billion. In other words, business spent about $100 billion more than its savings, and hence contributed greatly both to the high level of employment and the inflation. (In the Korean War, there has been a rise of output of 1½ percentage for every percentage increase in prices; in World War II, the ratio was 3 to 1).

The conclusion drawn from the analysis so far is that the economy is not likely to be stimulated by a high level of building activity, purchases of other durable consumer goods, or by a high level of investment greatly exceeding savings of business as in the years 1946-52, *or even* 1946-53.

GOVERNMENT AND EXPENDITURE

But what of government? Since 1939, government has played a vital part in keeping the economy active—approximately $500 billion spent for national security up to the present. This includes foreign aid. I am not suggesting that the prosperity of the last 13 years is explained only by military outlays. The fact is that the nation's income over 20 years, 1933-52, was about $2,200 billion in excess of what the income would have been had it not risen above the depression low. This large excess cannot be explained merely by security outlays. *But it has not yet been shown that the economy can be maintained at a high level without substantial government outlays and even deficits.*

My distinguished colleague, Professor Sumner Slichter, is more optimistic on this score than the writer. He envisages little difficulty even if military outlays are cut by $30 billion; he bases his optimism on the theory that Americans are good spenders and always adjust spending to income after taxes (hence reduce taxes and spending will rise correspondingly); and on the theory that investment, even if below current high levels, would absorb savings made available, the explanation apparently being the high place given to research in American industry. This analysis does not explain away, however, the difficulties of the thirties, nor the relationship of a decline of income and the ensuing larger cuts in expenditures on durable goods. Should the initial drop be averted, or should it be accompanied quickly enough by corrective measures, then the economy may be saved a cumulative decline.

In some of his writings, it should be noted, Professor Slichter justified a growing government deficit as the practical means of providing the economy with the money required as it grows.

IN view of the importance of preventing a decline with its accompanying effect on confidence, or of acting quickly in response to a decline, it is well to consider the current state of public policy.

In the years 1946-52, the effect of the operations of the Federal government were deflationary, for receipts exceeded expenditures. (State and local government, however, had a net inflationary effect). Included in the government balance sheet is its contribution to the excess of exports; but should this excess, insofar as financed by government aid, be credited to the government, then the government's deflationary effect on the domestic economy would be so much larger.

In the 3½ years ending June, 1949, the United States imported $30.5 billion of goods and services and exported $62.9

billion. Government aid accounted for $19.6 billion, or more than 30 per cent. of the exports, and roughly 60 per cent. of the excess. In the next 3½ years, government aid financed less than 25 per cent. of the exports and roughly the entire *excess* of exports.

* * * *

FINANCIAL AND FISCAL POLICY

Perhaps the crucial issue in the next few years relates to public policy. The government is still inflation conscious; but despite the inflationary pressures of large public outlays and high investment levels, prices have been moving downwards slightly for 2 years. *The result is that the government may be administering a sedative when what is required is adrenalin or benzedrine.*

Recent interest rate policy reflects in part this concern for inflation as well as a strong penchant for a free market. In recent years, the government, in collaboration with the reserve banks, has tended to support the government bond market. At times, the government's concern over the price of its securities in influencing monetary policy may have been excessive; and in the years 1946-51 a case could have been made for a somewhat more severe monetary policy, with rates rising more than they actually did.

But the Administration, fearful of inflation, may well have been using a sledge-hammer when a scalpel might serve. The bond market is rather demoralized, with experienced investors awaiting minimum prices for bonds (maximum rates) before they buy—the average rate on government securities is now 20 per cent. above the war-time level and long-term rates have risen from 2½ per cent. to 3¼ per cent. *The rise in interest rates at this time may well discourage investments in housing, durables and in other channels.*

Furthermore, the government is greatly concerned over the tax burden and the national debt. These are, indeed, large and at record levels. As a result of the alarm over solvency and the integrity of the dollar, the government would hesitate to intervene promptly should a decline appear. But fear of bankruptcy is over done. Taxes at $95 billion are very high compared to the $7-8 billion of 1933; but income has increased 3 times as much. The debt of $265 billion is also very large; but the cost of financing is less than 1/50 of the rise of income since 1933, and the amount compared to the national product is down, around one half compared to the relationship at the end of the war.

THE great danger is that the government will sit back and do nothing; and even prompt action, given existing mechanisms and institutions, means serious delays. On this score I am pessimistic. The ray of hope lies in the general distaste of taxation. A depression may be countered by large cuts in taxes; but we cannot even be sure of this. The economics of Keynes, Hansen and Copeland has not really penetrated Congressional circles. *Budget balancing, on a yearly basis irrespective of the harm done to this country and the free world so dependent on our investments, grants, purchases, and military support, is still accepted by the vast majority of the population and the Congress.* There is little attention given to the relation of the tax bill or the debt bill to the national income or the effects of disbursals on income.

But I do not want to be unduly pesimistic. Of course, an extension of the war will at least give us a sham prosperity; but the costs would be tremendous.

ECONOMY LESS VULNERABLE

What is encouraging is that our economy is much less vulnerable to a continued decline of demand than in the thirties. Whereas social public welfare expenditures were but $7 billion in 1935-36, they are around $24 billion today. The two important social security trust funds alone have $25 billion available, a substantial part of which could be used as unemployment gains. These would help maintain spending. Again, our tax system is primarily one of direct taxes as compared with 1933, and, therefore, substantial tax relief becomes available even before tax rates are cut. The farmers are protected by price supports; the worker's income by strong trade unions and an awareness of the damage done by *general* wage cutting. Consumers are much better protected by large holdings of liquid assets (though debts are high); and business by much smaller relative debts. At least the experts know much more about how to stimulate the economy through monetary policy, fiscal policy, and in other ways.

A depression of the magnitude of the thirties would cost this country $1,200 billion, or 2-3 times the cost of World War II to this country. The effects upon other countries, considering our contributions to military aid, international financing, to the world market for goods, and to the fight against communism, would be serious indeed.

* * * *

But I must italicize the fact that a depression of this order is out of the question. The greater part played by government and the reduced relation of spending and current income generally emphasize the reduced vulnerability of our economy to downward pressures. *But it has been my contention that we cannot rule out the possibility of a moderate depression.* A decline of defence orders; the relatively saturated condition of the markets for all durables; the slowness with which government reacts, partly because of lack of knowledge and partly because of the cumbersomeness of the machinery—these all strengthen the possibilities of trouble.

1955—A DANGER YEAR

AFTER a careful survey, the Department of Commerce concludes:

"The projected decline in defence spending in 1955 would provide a serious test of the strength of the economy. Particularly is this so since the reduction would be almost entirely in government purchases from the durable goods and construction industries, which may also be experiencing slackening demand in the private investment field unless that adjustment is completed earlier. Thus, 1955 appears to be a year in which it will be of major importance sizably to expand private markets to maintain a high level of business activity."

* * * *

Contributed articles by noted authorities in Australia and overseas dealing with matters of public interest are published from time to time in the I.P.A. Review. This Institute is not necessarily in full agreement with the views expressed in these articles. They are published in order to stimulate free discussion and inquiry.