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PLANNING AND FORECASTING IN THE TRANSITION PERIOD

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Formal discussion of the economic outlook by economists at meetings of professional associations is a long-established practice. In the twenties a luncheon session devoted to this subject was a regular feature of the program of the American Statistical Association, which at that time dealt to a large extent with economic realities—such as when to buy stocks—while the Economic Association meetings were more concerned with the hypotheses of neoclassical theories. There seems now to have been a change—the statisticians are emphasizing hypothetical mathematical formulae and the economists are greatly concerned with the immediately current problem of the public debt.

Since the twenties, when these forecasting luncheons were the most popular of all meetings, particularly if held within the proximity of Wall Street, there have been great changes in the objectives and procedures of economic analysis. At that time the aim was to predict the course of events that was presumably the result of freely operating competitive forces in the markets with little influence from public controls. Since then we have had more widespread acceptance of the view that economic forces and events can be planned and controlled toward certain objectives. In line with those views and because of the pressures of a great depression, government has instituted many more regulations and restrictives and has adopted stimulative measures aimed to relieve distress and to minimize fluctuations in employment and incomes.

This important change in the institutional structure of the economy necessarily modifies both the function and the task of forecasting. During the depression of the thirties, after a period of floundering in the hope that free private enterprise would finally touch solid bottom and be able to walk out of the slough, since it was too burdened with debt and tradition to swim, government took over. At first it almost smothered the poor victim with a superabundance of aids, some of which were misdirected. After this development an important aspect of forecasting was to predict governmental policies—especially the budget. In time private activities and judgments again became significant but on the whole continued too timid and uncertain to dominate the picture as they had in the twenties.

Then came the war and governmental activities became completely dominant. Forecasting was relatively easy, because the problem was primarily one of measuring the capacity of the economy to produce and of appraising the ability of government to keep private spending and market prices under control.

The postwar transition brought the first real test of planning and of forecasting in a partially planned economy when private activity needed no special stimulus. Viewing the results from this still rather close point, it appears that the test was not wholly favorable for either planning or forecasting, especially from the standpoint of the public's attitude toward these activities. It is important for economists to consider why this was true. A great many papers have been written on this subject and at another session devoted to the subject of transition forecasts, Frank Garfield's excellent paper seems to me to point out the principal deficiencies of the official forecasts made shortly after V-J Day for the transition period. These forecasts influenced although they did not completely determine the planning that was done and the policies adopted for that period and the public's viewpoint toward those policies.

Economic Developments in Transition Period. What happened? That question brings me to the assignment given me on this program: a review of recent developments that might provide the background for the forecasts to follow. The story of what happened is generally familiar. The President in his first Economic Report transmitted to Congress on January 8, 1947, as required under the Employment Act of 1946, has provided a comprehensive, yet concise, and an accurate description and analysis of the events. Time does not permit the presentation of a complete story here, nor is it needed for this audience. I shall only mention some of the more important developments that have a particular bearing on this problem of planning and forecasting.

Upon the termination of hostilities there was a lot of uncertainty and difference of opinion as to what would be the trend of economic events in the transition period. It was freely predicted that there would be a considerable volume of unemployment and at the same time there were fears of inflation. It was known that there would be a decline of 70 billion dollars in the annual rate of federal government expenditures, which had been accounting for about half of the total output of the country. It was certain that large numbers of war workers were going to be thrown out of jobs, that many would be released from the armed forces, and that reconversion in some lines would take considerable time. At the same time it was known that supplies of all sorts of goods and services were small and that the public in general had a lot of money to spend. Whether they were going to spend it in a sufficient amount to create all the employment needed was the important question. Some views tended to emphasize the available buying power, and the limited supplies of goods, while others were impressed by the employment problem.

We know now which course the buying public chose to take. We know that the consumer determined the trend of events. We might say that mistaken predictions on the part of many were, to use a popular advertising slogan, because they "underestimated the power of a woman." The consumer, in general, is responsible for the fact that there has been so much employment and that we had such pressure on prices.

Federal government expenditures declined in accordance with expectations from an annual rate of above 100 billion dollars a year to below 40 billion. Government expenditures are now close to a stabilized level and are approximately balanced by receipts, so that the government is no longer the dominant stimulative factor in the economy.

Private expenditures, at the same time, increased much more rapidly and by much larger amounts than was generally anticipated. The decline in government expenditures was at first more rapid than the increase in private expenditures and there was some decrease in over-all production and income. This decrease, however, did little more than reflect the reduction in working hours and in overtime pay, other relaxations of wartime pressures for maximum efforts, and the shifting of people and equipment from one task to another. There was relatively little unemployment, considering the nature of the readjustments being made, and no relaxation of pressures of large demand on short supply.

Expansion of consumer expenditures was, as I stated, the outstanding development in the transition period. It was far beyond previous expectations. Expenditures on nondurable goods and services, which continued at a high level throughout the war, expanded further, although the growth in the latter part of 1946 was probably not as great as the rise in prices, indicating some decline in physical volume. Consumer buying of durable goods expanded rapidly with increased production of such goods, but continued below accumulated demands and potential capacity for production.

Some forecasters in 1945 expected that there would be a sharper decline in incomes than actually occurred and an accompanying decline in consumer expenditures for nondurable goods. The anticipated increase in supplies and purchases of durable goods was expected to curtail buying of nondurable goods. These declines did not take place. The simplest guide for forecasting consumer expenditures for 1946, as during the war, was the total supply available multiplied by the highest prices the sellers were willing or were permitted to ask. No correlations to income separately derived were needed.

Total consumer expenditures are now abnormally large, not only in dollar amount and in volume of goods and services, but with reference to the level of individual incomes, which are also at a high level. The net current savings of individuals, that is, the excess of income after taxes over consumer expenditures, have been sharply reduced since the end of the war. Net savings are currently at an annual rate of about 15 billion dollars, compared with a peak wartime level of nearly 40 billion dollars. The ratio of current net savings to disposable income is now below 10 per cent, compared with the wartime peak of nearly 25 per cent and prewar rates of less than 10 per cent.

This change in savings is an important factor in the immediate outlook. In this connection, however, it is significant and should be emphasized that these figures represent net current savings; that is, the difference between gross new savings by all individuals and current drafts on past savings. With the tremendous volume of liquid assets accumulated during the war, withdrawals from past savings might be expected to be much larger than would normally be the case. Hence past experience may continue to be an unreliable guide.

The willingness of people to draw upon their past savings to purchase durable goods has had and will continue to have an important bearing upon the volume of consumer demands. Liquid-asset surveys made for the Federal Reserve Board show that although people planned at the beginning of 1946 to spend only relatively small percentages of their total holdings, the amounts that they expected to spend were substantial with reference to the supply of goods available. This was a better forecast than those made by some economists.

Withdrawals from savings were unquestionably tremendous in 1946—gross redemptions of 6 billion of Series E savings bonds give an indication. In view of the rise in prices that has occurred and the purchases already made, the outlook for 1947 may de different. The next survey to be taken in January should indicate the extent to which the events of the past year have altered intentions. Current forecasts must allow for this factor.

Another important factor maintaining consumer expenditures at a high level relative to income, particularly those for durable goods, has been the rapid expansion in consumer credit. This expansion is likely to continue as more durable goods become available. Were it not for Regulation W, the expansion, and subsequent contraction, would be more rapid. Payments to veterans, including terminal leave compensation and veterans loans, have also been an important source of consumer income likely to be spent rapidly. Many of these will not recur in the future.

Expenditures for private capital formation, which were at a very low level during the war, have subsequently expanded to an annual rate of about 30 billion dollars, compared with prewar figures of around 15 billion dollars or less a year. These totals include expenditures for a great variety of purposes.

Residential construction has expanded rapidly; expenditures for this purpose are now far above the maximum for any year in the thirties and new contracts awarded this year have been well above the peaks of the twenties. To some extent this increase reflects higher prices, and the volume of building may be little above the level of the late thirties. Practically all of the new housing construction recently started was under the Veterans Emergency Program. The question for the future is whether the present high costs of building will cause deferment of demand for housing.

Nonresidential construction rose much more sharply than residential building following the end of the war and the termination of allocations and of permit requirements by the war agencies. Controls were subsequently reimposed and these activities were curtailed, but the actual expenditures on projects started or to be permitted continued large. Recently controls have been relaxed. Business is also buying new equipment in large amounts. Shortages are substantial in many lines and expenditures for producers' durable goods have been rising as fast as production could be expanded. What are the prospects for continuation of such a large amount of expenditures for industrial and commercial construction and equipment?

Business inventories, which were seriously reduced during the war in civilian goods lines, expanded at a rapid rate during 1946. Much of the large increase in recent months has reflected rising prices. This increase in inventories has been one of the most important stimulating factors in the recent expansion of incomes, and a slackening in that rate, which is certain to come eventually, will produce an important change in the situation. When can we expect the end of inventory expansion?

Exports of goods from this country have continued large and could be much greater if current demands were met. They reached a peak at an annual rate of 12 billion dollars a year, while imports have been below a 6 billion rate. American goods are in great demand and it appears that supply of goods rather than dollar exchange is still the most important limiting factor.

The most important and significant development of the transition period was the sharp rise in commodity prices that occurred in the last half of 1946. Prices were gradually rising during OPA controls, but with suspension of those controls last summer there was an immediate sharp upward spurt and another one followed the lifting of controls in October. Prices of agricultural products rose to about 250 per cent of the prewar level; they rose more than during the last war and in fact the increase in the six months May to November was as great as in three years from the middle of 1917 to the peak of 1920. Agricultural prices are now higher than at the 1920 peak.

Wholesale prices of industrial products have not risen during this war by anything like as much as they did in the last war—about 50 per cent compared with over 150 per cent—but further increases of these products are probably yet to be recorded. Retail prices of food, clothing, and many other nondurable goods have nearly doubled since 1939, and prices of durable goods have risen by about 50 per cent, while rents and many utility charges have shown little increase. The total cost-of-living index is up about 50 per cent.

During 1946 the country was faced with the alternative of further price inflation of a more serious nature than had occurred during the war or of rigid economic controls of a degree and character exceptional in our history. There was no other alternative because at the controlled level of prices demand was certain to be in excess of available supplies that could be provided in any short period of time. An attempt was made to maintain controls, but they were inadequate and in the end the course of inflation was chosen. The price rise that has occurred may surely be called inflation. Whether or not the consequences of this inflation of prices will be similar to those that have followed previous inflationary booms of similar scope is a question which the subsequent speakers are supposed to answer.

Responsibility of Planning and Forecasting. Other questions of concern to us as economists are whether the course of events might have been changed by more careful—or more fortunate—planning and forecasting and what lessons might be learned from recent events as to the future of these two functions of economists.

It may be said that incorrect forecasts were an influence in determining economic and other policies of government, of private business, and of labor, and in influencing the views of the public regarding those policies. In general a large number of persons who favored planning and controls as matters of public policy and some of those responsible for the controls adopted were guided by expectations of the future that turned out to be incorrect. The situation was one which required, if inflation was to be avoided, the most careful controls of a degree and stringency far beyond any previous experience in this country and of a nature widely believed to be contrary to our basic principles of government.

Official policies, it should be emphasized, were only to a small extent guided by the implications of the forecasts of increased unemployment and, on the whole, gave recognition to the dangers inherent in the situation and endeavored to maintain controls. Whether or not it was feasible or sound policy under the circumstances to maintain and enforce such controls in this country is a question which will be debated for many years. Events show that in the year 1946 it was politically if not economically impossible.

There was an important group of people, both vocal and numerous, who decried the forecasts of unemployment but at the same time opposed all planning and controls and claimed that the "free play of competitive forces" could solve all problems. It was not always clear whether they thought this course would permit a transition from war to peace without depression or without inflation, or whether they believed that one or the other of these consequences was inevitable in any event and would be less disastrous than the controls needed to prevent them.

In the light of events it seems clear that under the situation existing, in which demands at existing prices were far in excess of any supplies that could be attained in a short period of time, the "free play of competitive forces" would inevitably result in a rise of prices to a level far above what could be maintained when supplies again became available. This is what I would call inflation.

Conclusion. Whatever one may think of the justice and reasonableness of the decisions, it appears from the events of 1946 that the people of this country are not yet willing to accept economic planning, or at any rate the adoption of all the controls that such planning may indicate to be advisable. We cannot, therefore, rely upon an all-wise government to direct us in the paths toward permanent prosperity and full employment. Individual and business decisions will continue to be of great importance. As a basis for informed decisions, such guidance as the forecasts of economists can provide will be required. Under the circumstances, there will be sufficient unstabilizing elements in the economy to provide plenty of fluctuations to predict.