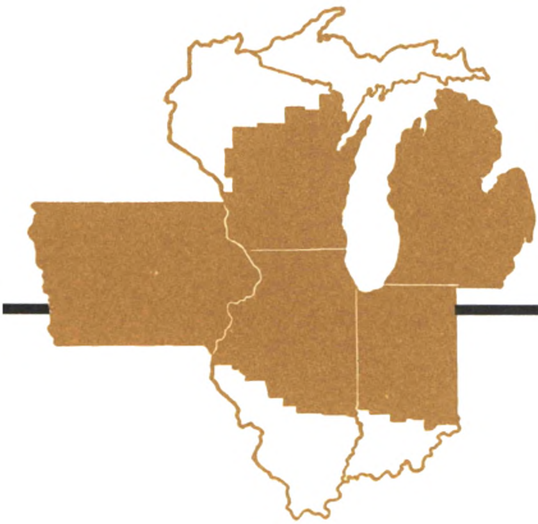
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1964 May

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THE Trend OF BUSINESS

Inflationary forces still in check

The view that in 1964 the nation will produce around 620 billion dollars of goods and services—6 per cent more than in 1963—is widely held. Some observers anticipate an 8 per cent gain, a projection that implies an annual rate of 650 billion dollars or more by the fourth quarter of the year. The possibility of such a large rise in the dollar volume of activity in so short a period of time is regarded with apprehension by some observers who believe it probably would be accompanied by rising prices, excessive inventory building and an unsustainable increase in the rate of business spending on capital goods and consumer spending on durable goods.

Some concern exists that the economy already is developing such stresses and strains. In part, opposition to the tax reduction bill, enacted late in February, reflected fears that the measure would excessively stimulate an already buoyant economy. Doubtless, spending in January and February was boosted in some degree by the conviction that the bill would be approved. Does the weight of the evidence suggest that excesses have developed thus far in 1964?

Price trends the key

Clear evidence of the overheating of the economy, when and if it occurs, will be found in movements of the major price indexes. As yet, these "thermometers" have shown little evidence of any strong rise in temperature.

Average consumer prices have continued to move up at a rate of between 1 and 2 per cent a year in recent months—mainly because of increases in services—as they have for the past five years. Wholesale prices in February averaged ½ of 1 per cent above the same month last year but were slightly below the level in the same month of 1961 and 1962.

The Labor Department's index of spot commodity prices was 4 per cent above its year-earlier level in mid-April as increases for all major nonferrous metals and steel scrap more than offset declines for agricultural products. Nevertheless, spot commodity

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prices averaged appreciably below the April level in 1961.

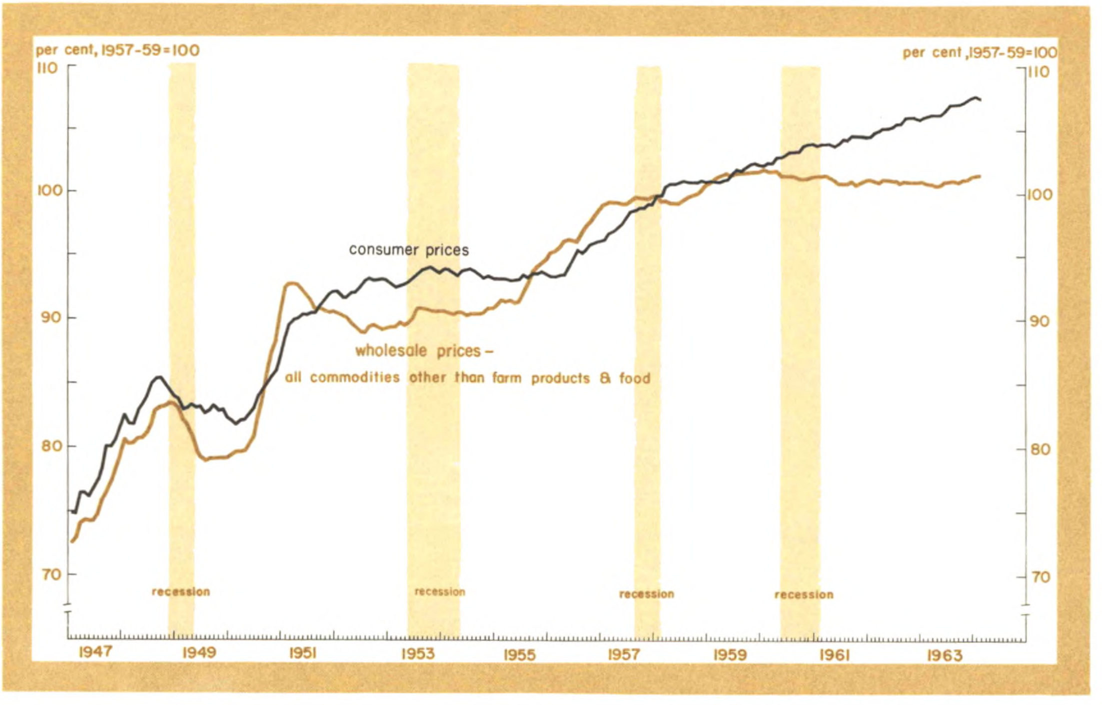
Price movements are of major importance in analysis of business conditions not merely because they reflect excessive demands upon available resources, but also because they tend to cause such developments to become cumulative. Expectations of progressively higher prices encourage businesses to anticipate future needs by increasing inventories and advancing purchases of "big ticket" durable goods. Such developments usually are followed by a reaction in the opposite direction.

Rising prices usually have been associated with booming business conditions in the later stages of an expansion. But there have been important exceptions to this generalization. Prior to the onset of the Great Depression of 1929-33, for example, the averages of both consumer and wholesale prices had been declining gradually for years. In the postwar period, rather general price inflation preceded the peaks of 1948, 1953 and 1957 but was much less in evidence prior to the peak in 1960.

Capital expenditures

Explanations of booms of the past often center about the decisions of business firms to purchase new plant and equipment. There has been a tendency for these outlays to be bunched, with enterprises competing with one

Consumer prices have continued their gradual climb in recent months while wholesale prices have risen slightly



another to obtain the buildings or equipment they desire as soon as possible. In such circumstances prices for these goods tend to rise sharply as order backlogs of firms producing capital goods increase. Such developments usually have led to sharp declines in outlays later. This sequence of events occurred, for example, in the capital spending upsurge of the mid-Fifties and its subsequent decline during the 1957-58 recession.

Between the first quarter of 1955 and the third quarter of 1957, capital expenditures rose 47 per cent, partly because of sharp price increases for these goods, while the gross national product increased 17 per cent. In the following year there was a sharp drop in such investments and a coincident decline in general business activity.

From the second quarter of 1961 when the current upswing in capital expenditures began through the first quarter of 1964, these outlays rose 23 per cent—only slightly more than the 19 per cent increase in the gross national product during the same period.

Government tabulations of business capital spending plans for 1964 indicate a rise of 10 per cent from 1963. It is possible that an even greater increase will occur, but these estimates have been remarkably precise in recent years except when recessions caused cancellations or postponements of programs. If the forecast for 1964 proves accurate, this would mean a moderate acceleration of the capital outlay uptrend. Capital outlays would amount to 7.0 per cent of the expected gross national product for the year compared with 6.7 per cent in the past three years. In 1956 and 1957 capital expenditures were 8.4 per cent of gross national product.

Because the size and rapidity of the current expansion in capital expenditures has been moderate, there has been little tendency for prices of capital goods to increase sharply as evidenced in 1956 and 1957. As a result, there has been only a moderate build-up in the order backlogs of machinery and equipment producers.

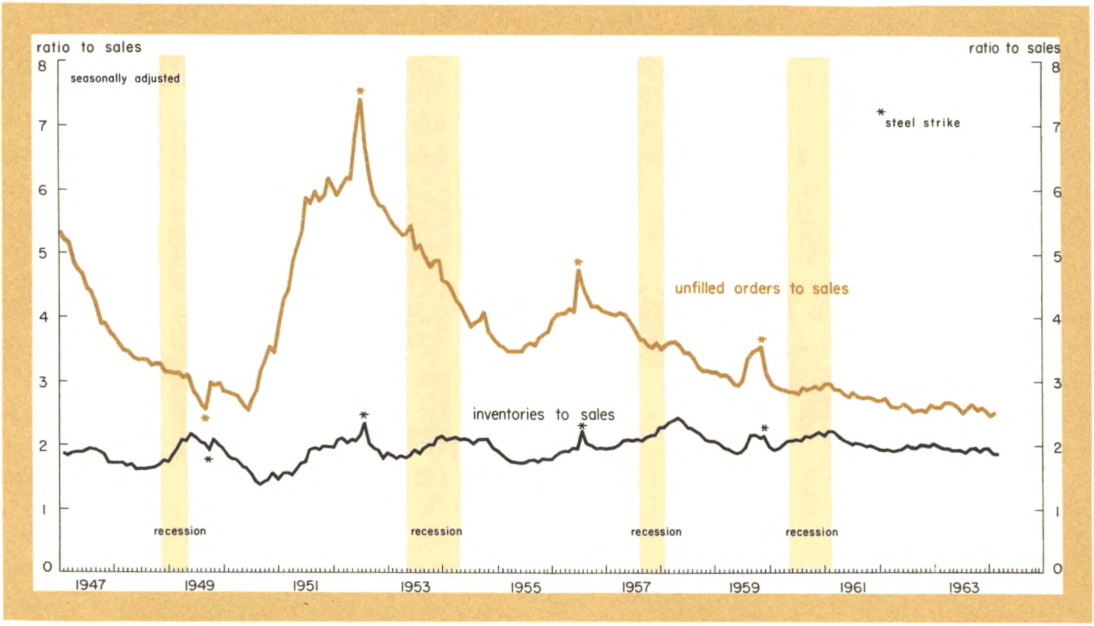
The current capital expenditure expansion has another favorable aspect in comparison with 1955-57. In the earlier period, the movement was dominated by programs to expand capacity in heavy industries producing basic materials—especially steel, aluminum, glass and cement. At present the rise in capital outlays, led by autos and steel, is more broadly based and a larger share of the total is for modernization and creation or expansion of capacity to produce finished goods.

Inventories relatively low

At the end of February, the book value of total business inventories was at a record high of more than 103 billion dollars—up 3.6 per cent from the level of a year earlier. But during the same interval total business sales rose almost 6 per cent. The ratio of inventories to sales was 1.48 in February compared with 1.51 a year earlier, the lowest for any similar month since the current series began.

Inventory fluctuations are especially important in the durable manufacturers category which is heavily represented in the Midwest. In these industries the processing cycle from raw materials to finished product typically is longer than in the case of soft goods. Moreover, during the past decade more and more of the burden of carrying durable goods inventories has been shifted from the retailers and distributors to the manufacturer, who must be able to ship goods quickly upon receipt of customers' orders. Consequently, inventories of durable goods manufacturers have increased relative to total business inventories and a larger proportion of manufacturers' inventories now consists of finished goods as opposed to purchased materials and

Orders and inventories of durable goods producers have remained low relative to shipments



goods-in-process. Because of these trends, the stocks of durable goods manufacturers provide a focus for consideration of the entire inventory situation.

There has been a slight decline in the inventory-sales ratio for durable goods manufacturers since the beginning of the current business expansion in February 1961 (see chart). Nevertheless, this ratio has been highly stable during these years when compared with the record of the earlier postwar period which was affected by steel strikes, recessions, inflation and materials shortages.

As long as sales are rising as much or more than inventories, there is no question of inventories overall becoming burdensome, although particular firms may encounter difficulties. Nevertheless, a stable or declining inventory-sales ratio does not necessarily guard against a business downturn, as indicated by the experience of 1948 and 1960. In the postwar period durable goods inventories have risen sharply relative to shipments only when the latter were reduced by steel strikes or recessions.

When business sales decline, inventories usually continue to rise for a time before the momentum of the inflow of goods from suppliers can be slowed. For this reason the current favorable business prospect is fortified not only because inventories have been rising less rapidly than sales but also by the fact that they are low relative to past periods of prosperity. Lower inventory sales ratios reflect accounting procedures that have reduced book values and improved inventory control has reduced the "fat" in these holdings substantially.

Business firms have a strong incentive to hold inventory growth in check: carrying inventory is costly in terms of interest, space, insurance and handling. These costs are estimated to total 10-15 per cent on an annual rate basis. In addition, inventories may lose value because of changes in technology, style or customer preference.

Potential delays in deliveries and prospective price increases, therefore, must be fairly certain and important to cause firms to increase inventory holdings beyond current needs. On the other hand, expectations of immediate substantial price increases or appreciable stretchouts in the time period required to obtain goods from suppliers can quickly overcome such caution. Avoidance of excessive inventory building, therefore, requires that comfortable margins of capacity be maintained in most industries.

Order backlogs low

The stable and slightly declining trend of the ratio of order backlogs to sales or shipments by durable goods manufacturers during the past three years contrasts even more strikingly with the earlier postwar period than does the trend of the inventory-sales ratio. From December to April, new orders of durable goods producers rose more than shipments with the result that order backlogs increased. Nevertheless, backlogs represented only 2.5 months' sales compared with a ratio of 2.6 a year earlier. In the early months of 1964, order backlogs of durable goods producers were the lowest relative to sales since the current series began in 1947.

Relatively small order backlogs held by durable goods producers provide an eloquent commentary on the ability of industry to manufacture goods as rapidly as required by customers, despite the long-sustained rise in demand. This phenomenon is closely tied to the fact that there has been little incentive to build inventories in this expansion resulting from fears of higher prices or of delays in deliveries.

If order backlogs begin to rise appreciably relative to sales, the movement doubtless will be accompanied by a lengthening of order lead times and a rash of price increases. That such trends might cumulate is obvious. The inflationary periods of 1950-51 and 1955-56 were characterized by such developments.

Thus far in 1964, order lead times have shown little tendency to stretch out except in some types of steel and construction machinery. In March only 17 per cent of the Purchasing Agents of Chicago reported that they were ordering supplies and materials 60 days or more ahead of requirements, compared with 18 per cent a year earlier. When the wholesale price index began to increase in mid-1955, this proportion was 39 per cent.

Relatively low order backlogs are viewed with disfavor by business managers who prefer to have sufficient orders on hand to keep their plants operating at a high level for many months to come, partly because economies result when longer runs of particular products can be scheduled. But a comfortable backlog for a producer represents an uncomfortable delay for the customer, who may be tempted to place duplicate orders elsewhere to make certain that the goods he requires are obtained on time. Obviously, large order backlogs in past periods compared with those of the present provide no assurance that a recession is not imminent as shown by the experience of 1953 and 1957. Orders can be canceled or set back, particularly when they represent defense work or duplications.

Labor supplies adequate

Equal in importance to adequate supplies of productive facilities in an expanding economy is an ample supply of manpower. Some observers have speculated that excessive pressure upon the supply of labor played as important a role in early postwar price inflation as shortages of materials. Today, expansion is hampered by an unfulfilled demand for certain types of workers with special skills or scientific training, but there can be no immediate question of an overall shortage of labor.

Unemployment, seasonally adjusted, averaged 5.5 per cent of the labor force in the first quarter—down from 5.8 per cent a year earlier and the lowest quarterly average since mid-1960. Nevertheless, the recent rate was far above the quarterly lows for the postwar period, for example, 3.5 per cent in the fourth quarter of 1947 and 2.6 per cent in the second quarter of 1953.

Aside from the extent of unemployment, the labor market may be kept relatively slack in the period ahead because of the growing number of young people who will be seeking work. In the past five years an average of 2.7 million persons reached the age of 18 each year, and almost exactly this number will reach 18 in the 12-month period ending July 1, 1964. During the period from mid-1964 to mid-1965, this number will jump almost 40 per cent to about 3.7 million, reflecting the sharp increase in the birth rate following the end of World War II. The number of persons reaching 18 each year will remain at about 3.5 million throughout the remainder of the decade before moving even higher.

In the first quarter of this year an average of 58.1 million persons were employed in nonfarm jobs, 1.6 million more than a year earlier and 4.5 million more than at the low point in the first quarter of 1961. This is an excellent record, but because of the probable expansion of the labor force, the number of job opportunities will have to increase even more rapidly in the future to prevent a rapid growth in unemployment.

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Trends in agriculture

Production of agricultural commodities has continued to increase fairly steadily, rising nearly one-fourth since 1950. But because of improvements in technology, there has been little change in the total amount of resources used by farmers. There have been large shifts, however, in the amounts of individual resources used, reflecting changes in relative prices and productivity.

Rising wage rates and the greater ease of managing mechanical equipment as compared with hired workers have spurred continued efforts to mechanize operations where possible, and farm use of fertilizer and lime has risen substantially.

In contrast, land used for crops has declined sharply. Land values have risen markedly but the impact of the higher prices on total farm costs has been softened somewhat by greater use of fertilizers, pesticides, herbicides, improved seeds and other developments which have greatly increased production per acre. The result, overall, has been a sizable gain in production per unit of resources used.

Innovations such as electrically timed automatic feeding equipment, bulk tanks and herringbone milking parlors for the handling of milk, multiple row tilling and harvesting machines and a host of such new developments as improved hybrid seeds, herbicides and pesticides—and more efficient management practices—also have made this possible.

Crop production per acre, for example, has risen nearly 40 per cent since 1950. Relatively high price supports coupled with acreage restriction on some crops provided farmers with a strong incentive to boost yields.

Production per livestock breeding unit has shown equally impressive gains. In the last few years, the number of milk cows has been at a low level and the number of chickens for egg production has dropped far below the average of the early Fifties, yet total production of milk and of eggs has been at or near record highs. Producers of broilers have greatly increased the efficiency with which feed is converted into chicken meat and cattlemen have boosted the liveweight production of cattle and calves without a commensurate increase in breeding stock.

Bigger farms

In an effort to increase their incomes, individual farmers have rapidly adopted improvements in technology and have been acquiring additional land with the result that many smaller farms have been absorbed or merged to provide larger units.

While the total number of farms declined about 27 per cent from 1950 to 1959 (based upon the 1954 Census definition of farms), the number of farms with gross sales of farm products above 20,000 dollars more than doubled and those with sales of 10,000 to 20,000 dollars increased nearly 50 per cent. Conversely, the number of commercial farms with gross sales between 2,500 and 5,000 dollars dropped nearly a third and there were 43 per cent fewer farms with less than 2,500 dollars gross sales in 1959 than in 1950.

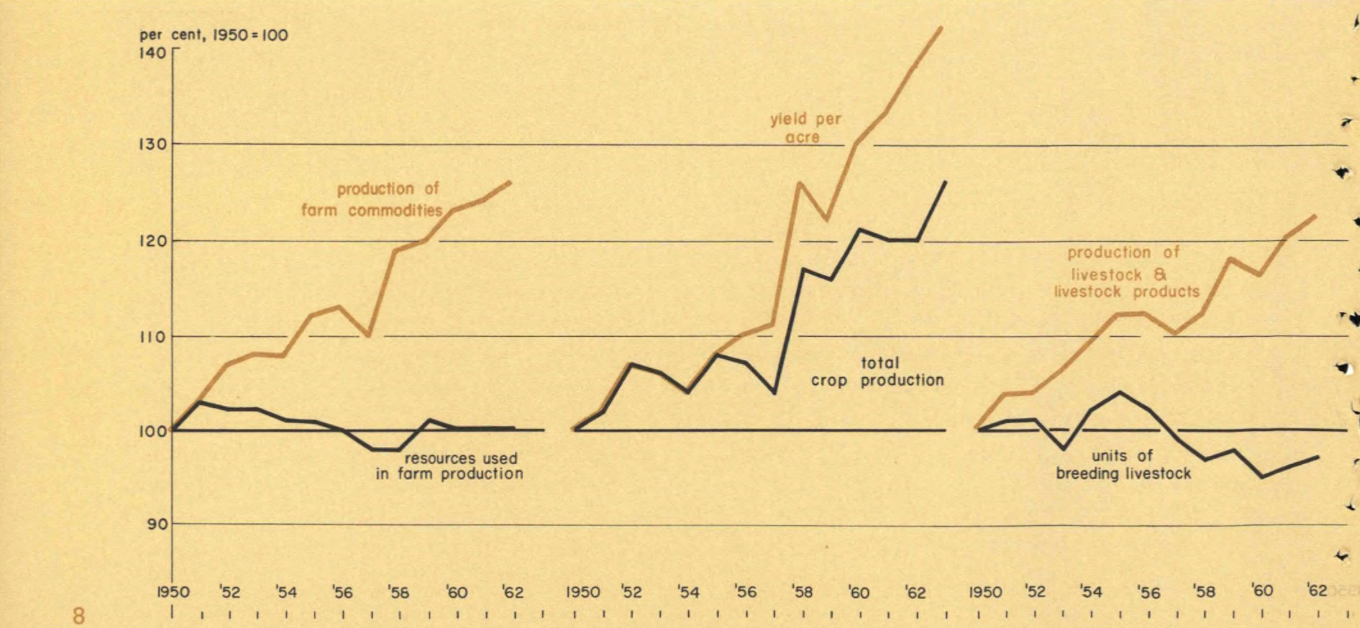
Farm assets rise

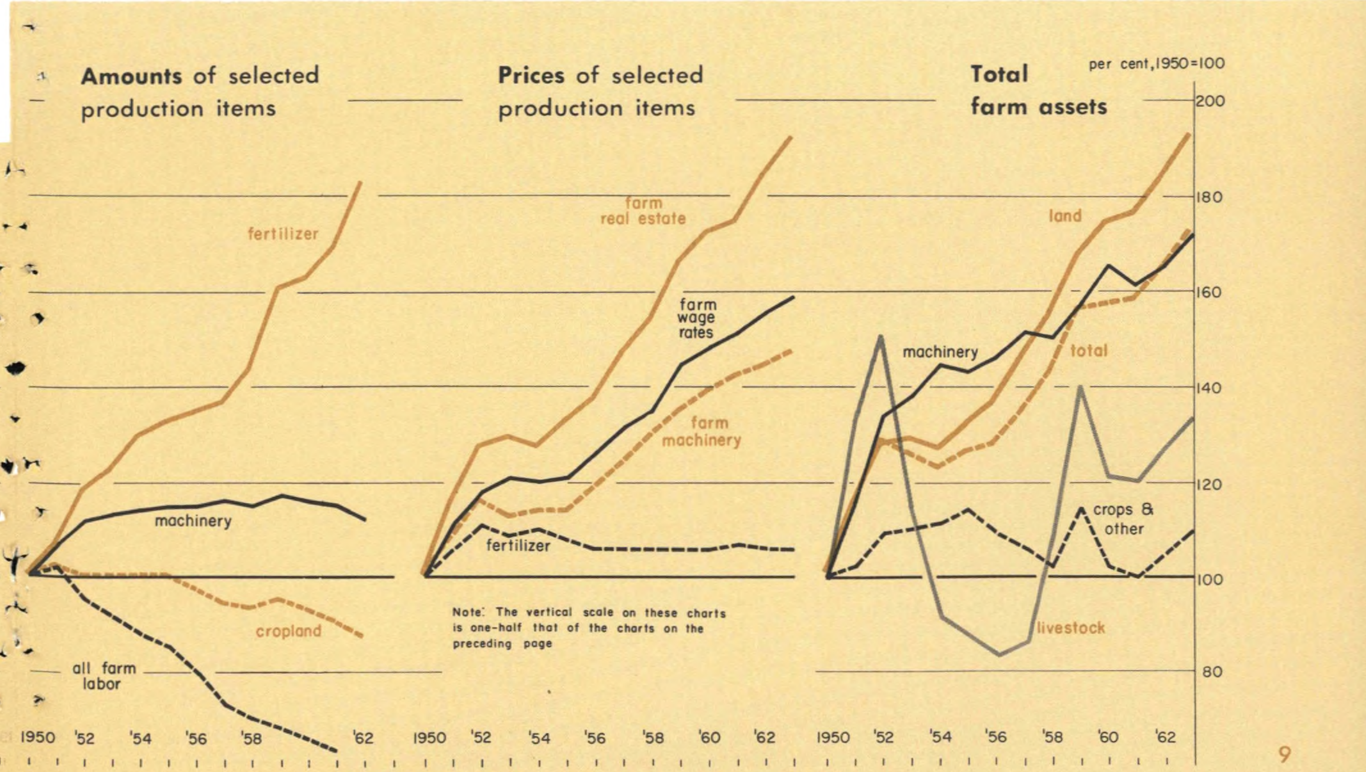
With the evolution of the commercial farm into an increasingly technical and more highly mechanized enterprise, the amount of capital invested per farm and per worker has continued to rise sharply. Total value of production assets in agriculture rose to 198 billion dollars in 1963 from 116 billion, or nearly three-fourths, during the past 14 years.

With the decrease in the number of farms, the value of production assets per farm increased nearly 200 per cent from 1950 to 1963. The value of real estate more than tripled and that of machinery and equipment more than doubled. Livestock inventories and other assets per farm (primarily crop inventories and farmers' deposits in banks) were also substantially increased—up 118 and 56 per cent, respectively. The value of assets per farm worker is now in excess of 25,000 dollars; there is an average of about two workers per farm.

Higher income per farm

Total net income from farming declined from about 14 billion in 1950 to less than 13 billion in 1963. However, net income per farm from farming has trended upward from about 2,400 dollars in 1950 to 3,580 last year. Also more farm families have increased the amount of off-farm work. As a result, income per farm from nonfarm sources has nearly doubled in the last 14 years and now accounts for about one-third of total net in-





come of the farm population from all sources.

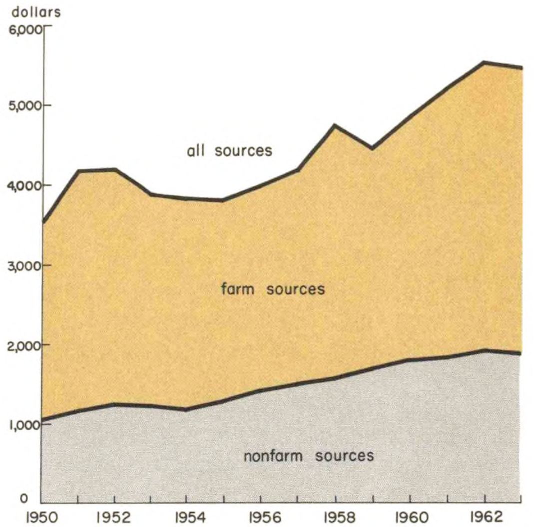
Credit needs expand

The amount of credit used by farmers has continued to increase sharply in the past few years. As farm real estate values have risen, more of the transfers of farmland have required the use of credit; farmers also have increased their use of credit to meet rising cash operating costs and to purchase machinery and other production items. Total farm credit outstanding has nearly doubled since 1950.

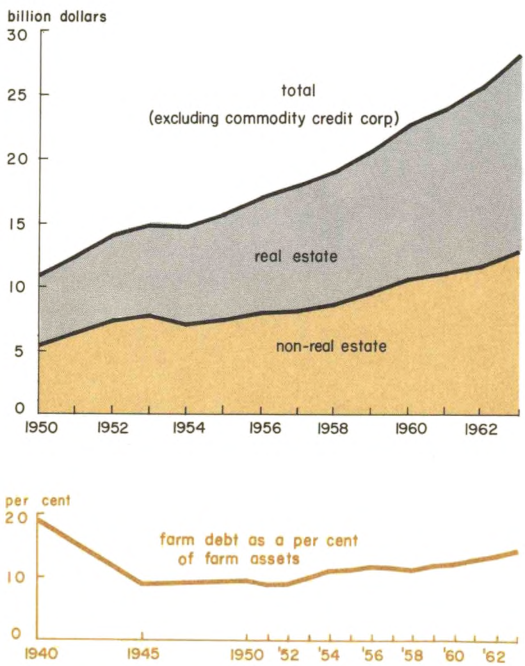
Despite substantial increases in farm debt, the ratio of agricultural assets to total farm debt is not as high as in many past years. Currently, the average ratio of farm debt outstanding to the value of agricultural assets is about 1 to 7. While the ratio of debt to assets has been creeping steadily higher during the past decade, it is still considerably below the ratios in the early Forties. Farm debt amounted to about 1 dollar for every 5 of agricultural assets in 1940.

The nation's farmers will undoubtedly find it necessary to continue to make extensive adjustments in their farming operations. Many of the causative factors underlying past changes are still present. Therefore, farmers will probably continue to enlarge their farms and substitute mechanical equipment and other capital items for manpower, and credit requirements likely will grow further as the changes are being effected. Net income from farming will probably continue to trend downward as higher production cost cuts into gross return but net income per farm is likely to continue to move to higher levels reflecting fewer but more efficient farms.

Net income per farm rises, with gains from both farm and nonfarm sources



Farm debt rises sharply



Regional economic integration

Trade between nations has grown spectacularly since the end of the second World War. There are many reasons for this, including the virtual collapse of international economic intercourse during the Great Depression and the severe disruptions of the economic fabric caused by the war.

An outstanding feature of the postwar growth of international trade has been the emergence and proliferation of trading blocs, whose major features are summarized in the accompanying table. Reflected here are both the economic and the political forces of a world undergoing rapid change. Each development reflects in its own way new awareness of the benefits to be gained by tearing down walls impeding the most efficient production and exchange of goods and services among nations that are endowed differently with material and human resources. Changing technologies of mass production may have made the expansion of markets for materials, capital and finished goods even more imperative than heretofore.

The Marshall Plan inaugurated by the United States in 1948 laid the groundwork for renewed cooperation among Western European nations, both former allies and former enemies. Out of it grew the European Payments Union, the European Monetary Agreement, and the Organization for Economic Cooperation and Development of which Canada and the United States are members. But more important, it helped spark the first large-scale peacetime experiment in regional integration in Western Europe: the European Coal and Steel Community (ECSC). Fathered by the late French premier Robert Schumann, the ECSC set France, Germany, Italy and the Benelux countries (which previously had already formed an economic union) on the road to economic unification.

When it became clear that the results of this pooling effort had surpassed the boldest expectations—the idea of a limited supranational governmental arrangement having now been accepted in fact as well as in principle—the six ECSC countries joined forces on a considerably more ambitious project of economic cooperation, the Common Market or European Economic Community (EEC) —sometimes referred to as the "Inner Six" —which envisages the eventual political unification of Western Europe. It rests on a comprehensive legal document, the Treaty of Rome, and has been a going concern in a number of activities since early in 1958.

Early efforts to enlarge the Common Market's geographical scope failed, however. This set off a movement toward an independent association of European countries that were likewise pledged to the dismantling of tariffs and quantitative restrictions on trade: the European Free Trade Association (EFTA) or "Outer Seven." Subsequent attempts to merge the two groups were unsuccessful, but the door to such a development in the future is still ajar.

Both groups continue to develop working arrangements with additional countries. An agreement creating an association between the EFTA and Finland became effective in 1961. Under it, Finland has assumed substantially the same obligations as those of full

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A checklist of economic alliances and associations

Origin, membership, area, population and gross national product[1]	Organizational structure	Objectives
EUROPEAN COMMUNITY:		
European Coal and Steel Community (ECSC)		
Treaty of Paris, 1951, in effect since 1952. Belgium, France, Germany, Italy, Luxembourg and Netherlands. 449,000 square miles; 178 million; $235 billion	Legislative: European Parliamentary Assembly (142 members, elected by and from national parliaments) Executive: Council of Ministers (6 members, each representing a national government), High Authority (9 members, independent of national governments) Judiciary: Court of Justice (7 independent judges forming supreme court of appeal on all Community matters)	To pool the member countries' resources of coal, steel, iron and scrap in a single market
European Economic Community (EEC)—Common Market		
Treaty of Rome, 1957, in effect since 1958. Same as ECSC	Legislative: Same as ECSC Executive: Council of Ministers (6 members)—basic policy decisions, EEC Commission (9 members)—day-to-day administration Judiciary: Same as ECSC	To pool the members' economic resources over a 12-15 year transition period in a customs union within which goods, persons, services and capital will move freely, to set up a common external tariff, and to coordinate policies in other fields
European Atomic Energy Community (Euratom)		
Treaty of Rome, 1957, in effect since 1958. Same as ECSC and EEC	Legislative: Same as ECSC and EEC Executive: Council of Ministers (6 members), Euratom Commission (5 members) Judiciary: Same as ECSC and EEC	Through coordination of research and projects to give the Community a powerful nuclear industry pledged to the peaceful uses of atomic energy
OTHER ASSOCIATIONS:		
European Free Trade Association (EFTA)		
Treaty of Stockholm, 1959, in effect since 1960. Austria, Denmark, Norway, Portugal, Sweden, Switzerland, United Kingdom. 767,000 square miles; 92 million; $130 billion	Legislative: None (Stockholm Convention) Executive: Council composed of representatives of member states (one vote each), meets at both official (delegate) and ministerial levels, office of chairman rotating among member states. Permanent secretariat (Geneva) in charge of day-to-day business Judiciary: None	To abolish—in stages—tariffs and quantitative restrictions between member countries, with a view to promoting sustained economic expansion, full employment and higher standards of living (in contrast to EEC, no common external tariff is envisaged)

[1]1963 data, partly estimated.

Progress to date	Growth in trade	Problems
From 1953-58 ECSC established a common market for coal, steel, and related products. Has helped to double steel production from 1953 to 1963; has reorganized the coal industry and harmonized discriminatory transport rates	ECSC intracommunity trade in coal, steel, etc., rose some 200 per cent from 1952 to 1960 (as compared with growth in output of these products of 35 per cent)	Closing down of uneconomic coal mines delayed; some overexpansion of steel production capacity
With acceleration of timetable, by July 1963 internal tariff duties cut to 40 per cent of their 1957 level (20 per cent lower than scheduled) and some adjustments made in external tariffs. Import quotas on industrial products eliminated in 1961	From 1958 to 1963 EEC intracommunity trade increased 130 per cent while trade with the rest of the world rose about 44 per cent	Despite basic agreement, integration of EEC agriculture remains more phantom than substance; implementation of basic principles of agricultural policy lagging
Euratom has established a common market for nuclear materials and set up a joint nuclear research center		
Following accelerated timetable, by end of 1963 intra-EFTA tariffs had been reduced to 40 per cent of 1960 levels (to keep in step with EEC)	From 1960 to 1962 intra-EFTA trade rose 16 per cent while trade with other countries increased about 7 per cent	Administration of system of "national origins" to prevent foreign goods imported into low-tariff member countries from being re-exported to high-tariff member countries

A checklist of economic alliances and associations (continued)

Origin, membership, area, population and gross national product[1]	Organizational structure	Objectives
Latin American Free Trade Association (LAFTA)		
Treaty of Montevideo, 1960, in effect since 1961. Argentina, Brazil, Chile, Colombia[2], Ecuador[2], Mexico, Paraguay, Peru, Uruguay. 6,676,000 square miles; 181 million; $71 billion[3]	Legislative: Conference of the Contracting Parties composed of representatives of member countries Executive: Standing Executive Committee, Secretariat of Standing Executive Committee Judiciary: None	To expand and diversify trade and promote progressive complementarity of member economies; over a 12-year period and through tariff reductions of not less than 8 per cent a year to bring area free trade into full operation
Central American Common Market (CACOM)		
Treaty of Managua, 1960, in effect since 1960. Costa Rica[4], El Salvador, Guatemala, Honduras, Nicaragua. 170,000 square miles; 11.8 million; $2.6 billion[3]	Legislative: Central American Economic Council composed of finance ministers of signatories Executive: Executive Council, Secretariat of the General Treaty for Central American Integration Judiciary: None	To achieve free trade, freedom of capital movement and a common external tariff by 1966; establishment of monetary union and harmonization of policies in various fields envisaged
Council for Mutual Economic Assistance (COMECON)		
Established under Soviet leadership in 1949 in answer to the Marshall Plan. Albania[5], Bulgaria, Czechoslovakia, East Germany, Hungary, Outer Mongolia[6], Poland, Rumania, Soviet Union. 9,635,000 square miles; 326 million; GNP unknown	Legislative: None Executive: Executive Committee composed of representatives of all COMECON members Judiciary: None	At first to promote economic self-sufficiency; later to encourage member states to specialize in lines of production for which they are particularly well fitted, to tie their economies more closely together and to create an integrated market

[2]Joined in 1961. [3]Gross domestic product. [4]Joined in 1963. [5]Inactive. [6]Joined in 1962.

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members of the organization in relation to most of its trade with EFTA countries.

In 1962 the EEC concluded an association agreement with Greece that provides for the gradual establishment of a full customs union, with special measures to protect and develop the largely agricultural Greek economy. An association agreement with Turkey was signed in 1963, but this will become effective only after ratification by the parliaments of the EEC member states and Turkey. Furthermore, the former African colonies of EEC member countries are linked to the Common Market by special agreements assuring privileged access to European mar-

Progress to date	Growth in trade	Problems
Three tariff-reducing sessions of the Conference of Contracting Parties achieved overall cuts of about 25, 15 and 10 per cent, respectively	Zonal exports in 1962 rose about 20 per cent over 1961 (but not at all compared with 1950)	Trade among members has remained a small portion (about 7 per cent) of their total trade since 1960; industrialization still heavily dependent on outside imports; lack of coordination of member economic policies and customs systems; inability to speak with one voice in trade negotiations with outside world; zonal payments system undeveloped
Free trade largely established, customs union nearly complete (tariffs unified on more than 95 per cent of customs list items); C. A. Clearinghouse in operation, treaty signed establishing C. A. Monetary Union with view to adoption of single currency at par with U.S. dollar	Intra-CACOM trade in 1962 rose about 37 per cent over 1961 (but still accounted for only 9 per cent of total trade)	Inadequate network of transportation; shortage of risk capital to finance new industries
First multilateral trading agreement between COMECON countries signed in 1957, but system of bilateral settlements retained; International Bank of Socialist Countries, providing a mechanism for multilateral settlement of trade debts, began operations in January 1964; some progress toward a common energy policy achieved	Between 1950 and 1961 trade among COMECON countries increased 3-4 times as fast as industrial production; COMECON trade with non-Communist countries in recent years increased faster than intrabloc trade	In the absence of agreed-on criteria for comparing costs as a guide to specialization, how to substitute a multilateral trading system for the bilateral agreements now in force between member states; delay in modernization of trading price structure (to bring it into line with changing world prices); opposition within the bloc to greater integration, especially when interpreted to mean a Soviet-dictated program of specialization

kets for their products and committing the EEC to help in financing their development projects.

Cohesion among the "Inner Six" was seriously jeopardized early last year when the negotiations with Britain, which had been widely expected to lead to Common Market admission of EFTA's leading member, broke down. Both EEC and EFTA have since continued to implement the accelerated timetables for tariff reductions previously agreed upon.

Meanwhile, five Central American and nine Latin American nations had made some progress toward achievement of similar goals. The Central American Common Market

(CACOM) is basically modeled after the EEC, while the Latin American Free Trade Association (LAFTA) follows, with some variations, the pattern set by the EFTA. Intracommunity trade among members of the integrating groups in the Western Hemisphere, however, is quantitatively much smaller than that of the Western European trading groups.

The same is probably also true of the Council for Mutual Economic Assistance (COMECON), an organization tying together the Communist-dominated countries of Eastern Europe. COMECON, which operates under different ground rules, has recently undergone some major changes whose importance is not yet evident.

While the benefits of regional associations are many, some danger exists that these trading blocs will substitute for the obsolete *national* trade barriers of their members *regional* obstacles of a similar kind. There is some evidence, for example, that in the agricultural sector the Common Market will maintain high levels of protection against outside competition. Political boundaries, however, whether they encompass one country or several, bear no consistent relationship to the distribution of the world's productive resources and thus to geographic advantages and disadvantages in the production of goods and services. Consequently, it is important that barriers to trade between blocs as well as those between individual countries be progressively lowered. Some test of how much —if any—progress can be achieved along these lines will be furnished by the impending "Kennedy round" of trade negotiations under the General Agreement on Tariffs and Trade (GATT) in which the United States, the EEC and members of the EFTA will each play a leading role.

Business *continued from page 7*

The importance of psychological elements in business fluctuations has been recognized since these phenomena first came under systematic scrutiny. When a business upsurge is in process, expectations—and therefore speculations—are apt to outrun the real potential of the movement, and, similarly, a downturn is likely to cause the emotional pendulum to swing too far toward the extreme of despair.

At one time, the literature of business cycles gave great weight to the effects of changes in psychology. The "normal" condition of the economy was thought to be stability or moderate growth interrupted only occasionally by "panics" and "booms" with extreme cases of the latter labeled "bubbles" certain to be deflated. This characterization of the economy has long since given way to "recession" and "expansion," suggesting a more mature economy and a more sophisticated population.

The extent to which individuals and business firms have avoided the more serious extremes of emotional reactions to changes in business conditions is shown in many of the economic data that describe economic developments of the past decade. In part, this reflects growing confidence that the business cycle can be moderated if not eliminated entirely through wise private and public policies. This confidence will be fortified further if stable growth can be achieved in 1964 for the fourth successive year without the excesses that lead to a general rise in prices. At the present time the prospects are easily "fair" and probably "good" that this favorable condition will be realized.