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Office of Business Economics

Statement by Louis J. Paradiso, Associate Director, Office of Business Economics, U.S. Department of Commerce, at the 41st Annual Agricultural Outlook Conference Washington, D. C., Monday, November 18, 1963

Examination of recent and current developments together with the little information we now have on government and private programs, suggest that the economy has enough upward momentum to keep rising during the first two quarters of next year. Without a tax cut, the prospects after mid-1964 are quite blurred. A reasonable position is that the economy would continue to move up but at a limping pace at best. If a tax cut is enacted early in the year, however, private demands will be greatly stimulated and the economy should move ahead throughout the entire year at a faster pace than this year. It is too early to try to set forth specific GNP forecasts which can be soundly based. Many Government appropriations bills have not yet been passed; business investment programs in many cases are still tentative or have not been fully formulated.

If we assume the general 1964 pattern as I have indicated, the implications on employment and unemployment are impressive. If no tax cut is enacted, and assuming similar increases in the labor force, prices, and productivity which we experienced this year, employment next year would not show any substantial improvement over the average for this year. This implies that we would have little success in taking care of the additions to the labor force and the rate of unemployment could well rise from the 5.6 percent average for this year to a rate ranging from 6 to 6-1/2 percent next year.

On the other hand, if an early tax cut is enacted, prices may generally be firmer, productivity gains should be better and the labor force may expand somewhat more than this year. But production, demands, and employment would accelerate. The economy would grow at a fast enough pace to provide job opportunities not only for the newcomers into the labor force, but also for many of those now unemployed. Total employment in 1964 could increase by as much as 1-1/2 million over the average for this year. Under these conditions the unemployment rate would drop to around 5 percent as an average for the year and this would set the stage for the attainment of a much more desirable rate of 4 percent or less later.

Fixed Investment

Later this month the Government will have its first indication as to businessmen's capital investment programs for early 1964. Several private surveys have already canvassed the expectations for 1964. One survey has already reported a 4 percent rise and another an 8 percent increase. In each of these surveys when the economy has been in a rising phase there has been a tendency to understate the actual amount of the rise. Taking this factor into account, and considering the fact that machinery and equipment orders have been tending upward since the second quarter of last year, I would project the expansion in plant and equipment expenditures next year to be 7-10 percent and probably closer to 10 percent above the total for this year, or, in other words, an increase of nearly $3-4 billion from the $39 billion expected this year. Since plant and equipment expenditures are estimated at an annual rate of $41 billion in the current quarter (OBE-SEC basis) -- 5 percent above the 1963 total -- the indicated rise next year would mean no overly strong expansion.

In the event of an early tax cut, outlays for plant and equipment for 1964 as a whole would probably rise even more -- but not much more -- the acceleration in such spending would probably come in the later months of the year. The initial impact of reduced taxes would be on consumer demand. Investment outlays would be triggered only after sales have grown for some time and orders pile up. Thus, a tax reduction would assure the carrying through of existing investment programs and would result in the consideration and initiation of new programs with improving sales and profits prospects.

Inventories

In recent years total inventory demand has been geared especially close to the movement of economic activity. In other words, inventories have moved in a parallel fashion with GNP. In real terms, the level of inventories in 1961, 1962, and so far in 1963 has held at about one-fifth of the GNP. The inventory accumulation this year will be about $4-1/2 billion (GNP basis).

I would judge that if no tax cut is enacted, inventory accumulation in 1964 may again be of the order of $4-5 billion -- about the same as this year. This assumes that the rise in GNP in 1964 over 1963 would be somewhat less than that for this year and continuing relative price stability. If a tax cut is enacted, however, the expected additional increase in economic activity in 1964 would require a considerably larger inventory accumulation -- by perhaps as much as $3 billion more than the additions which are likely to be made without a tax cut. Such a rate of inventory building would be in line with the higher GNP and would be consistent with the recent cautious business inventory policy.

Consumer Expenditures

Finally, a few comments on the consumer sector. For some time, expenditures for nondurable goods and services have comprised a fairly constant proportion of disposable income -- about 80 percent. In view of the increases expected in the government and investment sectors, disposable income may be expected to move upward next year, and spending for nondurables and services may also be up -- in line with the usual ratio to income. In the last three years the proportion of service expenditures to spendable income has risen at a somewhat slower pace than in earlier postwar years. I would expect expenditures for services to again show a good increase next year, but probably show little change relative to the income rise.

Food, clothing, and other nondurable goods purchases are dependent upon population growth and, to a lesser extent, on income. This year these purchases are expected to increase $6 billion. Without a tax cut a somewhat smaller gain may be expected next year, and with a tax cut the increase may be at least half as much more than the rise this year.

A most important category of consumer spending from the point of view of the dynamics of the 1964 economy is consumer durables. This year automobile sales are expected to total 7.7 million units (including imports), compared with 7.1 million in 1962. So far in this model year, automobile sales have been exceptionally good. With this fast start and anticipated higher income, car sales may well top 7 million for the third consecutive year. However, unless the rate goes above this year's 7.7 million, the auto industry will not contribute to a further lift in GNP next year. If an early tax cut is enacted, the impact on durable goods buying should be substantial and, in particular, auto buying which is very responsive to income changes may be boosted to a new record high in 1964.

Furniture and appliance sales are to some degree dependent upon residential construction activity. It is expected that private nonfarm residential starts will total 1,500,000 this year, compared with 1,440,000 last year. Recent trends in housing activity, starts and permits, together with a consideration of household formation, vacancy ratios, and other factors, indicate no spectacular increase in housing activity next year -- perhaps a rise of the order of less than 5 percent. While furniture and appliance expenditures in 1964 might be up somewhat due to higher incomes and residential activity, the increase in these purchases may well be within the same range as that for residential construction activity.

In sum, the economy next year, as seen from a present appraisal, is expected to better this year's performance even without a tax cut but it will not be satisfactory all around -- particularly with respect to unemployment. A much more buoyant economy would result from a tax reduction and a lowering of our present high unemployment rate would be a most welcomed outcome.