

of Kentrick (44), Solow (45), the Bureau of Labor Statistics (46), and the staffs' study of 1957 (47).

Potential output: 1909-60

The production function derived above can be used to compute what the potential output could have been each year if there had prevailed a state of full use of resources. Two assumptions must be made. First, a value must be assumed for the cyclical term in the equation $\left(\frac{La}{Lp}\right)$. This variable was constructed on the assumption

that Lp , the potential labor input, reflected a constant rate of employment of 96 percent of the labor force and that average annual hours worked followed their trend without short-run, cyclical variations. If we use this as our standard for full employment, La can be set equal to Lp each year, the cyclical term becomes 1 and can be dropped out. The second assumption is that the potential output must reflect history as it had happened up to each year—bygones must be bygones. Thus, the Lp , K , and k assume the values in their actual historical series without adjustment for what might have been if full use of productive resources had in fact been continually achieved.

Potential output computed on this basis is shown in table 2, p. 37, and on chart VI. The movements are what one would expect—rapid growth during periods of relatively continuous prosperity with minor setbacks, as in the 1920's and 1950's, with actual output (Oa) varying around the potential (Op). On the other hand, the potential grew more slowly during the depressed years of the 1930's and output (Oa) fell substantially below potential (Op).