

# Chapter 1

## The Expansive Power of the American Economy

**T**HIS IS THE SECOND REPORT of the present Administration under the provisions of the Employment Act of 1946, which declares it to be a continuing responsibility of the Federal Government "to promote maximum employment, production, and purchasing power." The earlier Report set forth the conditions of economic progress in our country and in our times. By and large, the events of the intervening year have borne out the conclusions of that Report concerning the economic state of the Nation and the policies needed to promote sound economic growth.

### I. OBLIGATIONS OF FEDERAL GOVERNMENT UNDER EMPLOYMENT ACT

#### *The Employment Act*

The authors of the Employment Act wisely recognized that the main source of the economic strength of a nation consists in free institutions and the qualities of its people—their ambition, skill, enterprise, and willingness to make great efforts in their own behalf and in behalf of their families and communities. The Act therefore emphasizes economic growth rather than the mere stoppage or alleviation of business contractions. And it stresses the importance of using the powers of Government "to foster and promote free competitive enterprise," which has been the great energizer of our own Nation and of every other nation that has possessed the wisdom to submit to its discipline.

In framing the Employment Act, the Congress recognized that the Government has no way of guaranteeing prosperity and that, if a recession occurs, no single action or rule of policy will necessarily suffice to generate a lasting recovery. The Act does not prescribe what means are to be used by the Federal Government in promoting the basic objective of maximum employment and production. It does, however, specify that the means must be consistent with the "needs and obligations" of the Government and with "other essential considerations of national policy." In other words, in implementing the Employment Act, the Federal Government is subject to certain constraints. Among other things, it must honor the constitutional rights of individuals; it must respect the authority of the States; and it must protect the integrity of the money in which contracts are expressed and payments made.

The obligation of the Federal Government under the Employment Act "to promote maximum employment, production, and purchasing power," and to do so by means that are consistent with "other essential considerations of national policy," is not always remembered. Some citizens, lacking faith in the ability of the private economy to generate a high level of activity, espouse a steadily increasing role for Government. They urge new public undertakings and unbalanced budgets as devices for augmenting private demand, often with little regard to the cause or magnitude of any deficiency in demand. Other citizens, adhering to what they regard as the ultimate economic verities, are critical of any governmental action that is designed to prevent or to minimize the rigors of depressed incomes and unemployment.

These are extreme and doctrinaire positions. If the one is insensitive to the inequities of inflation, the other is insensitive to the misfortunes of depression. Each carries the danger of undermining, sooner or later, our system of free competitive enterprise. Neither is suited to our needs or our times. The American people believe firmly in economic freedom, but will not passively accept depression or inflation. The need of our times is for economic policies that, in the first place, recognize the proven sources of sustained economic growth and betterment, and in the second place, respect the need of people for a sense of security as well as opportunity in our complex and industrialized society.

#### *Basic Economic Tenets*

The economic actions of this Administration and its program for the future rest upon certain basic propositions. *First*, competitive markets, rather than governmental directives, are as a rule the most efficient instruments for organizing production and consumption. *Second*, a free economy has great capacity to generate jobs and incomes if a feeling of confidence in the economic future is widely shared by investors, workers, businessmen, farmers, and consumers. *Third*, the Federal Government creates an atmosphere favorable to economic activity when it encourages private initiative, curbs monopolistic tendencies, whether of business or labor, avoids encroachment on the private sector of the economy, and carries out as much of its own work as is practicable through private enterprise. *Fourth*, the Federal Government generates confidence when it restrains tendencies toward recession or inflation, and does this by relying largely on indirect means of influencing private behavior rather than by direct controls over people, industries, and markets. *Fifth*, the Federal Government contributes to economic growth when it takes its part, at the side of the States, in promoting scientific research and in providing public facilities, such as highways, hospitals, harbors, and educational institutions, on which the expansion of the private economy heavily rests. *Sixth*, the Federal Government strengthens the foundations of the economy when it widens opportunity for its less fortunate citizens and, working in cooperation with the

States and localities, helps individuals to cope with the hazards of unemployment, illness, old age, and blighted neighborhoods.

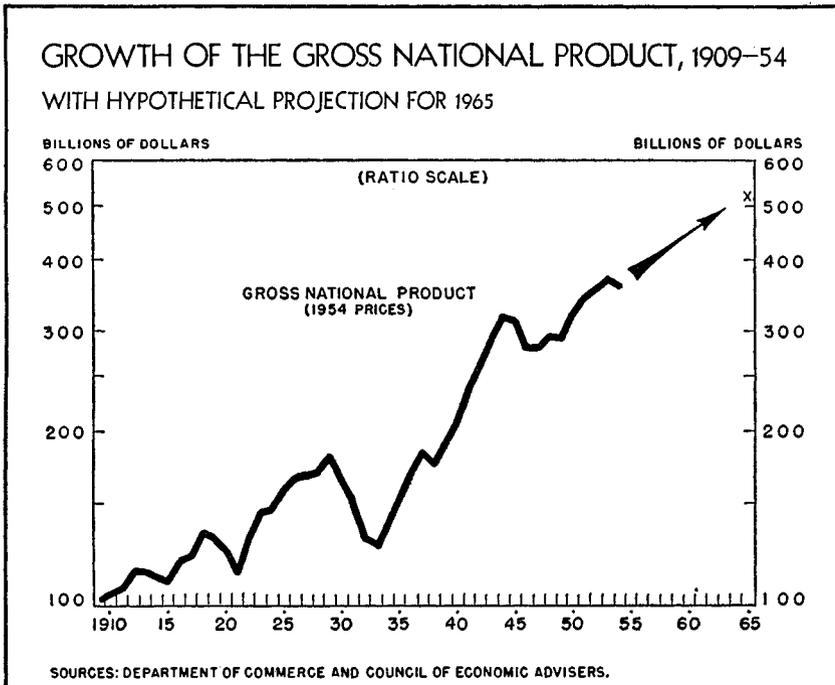
These economic tenets are basic and inseparable. They constitute guides to policies which, if pursued persistently, will advance us toward the goal of an increasing national income, shared equitably among those who contribute to its growth, and realized in dollars of stable buying power. In broadest outline they constitute the framework of an economic system that is at once strong and humane, a system that can provide both greater material abundance and a better quality of living.

## II. PATHS TO ECONOMIC GROWTH

### *The Growth Potentials of Our Economy*

The American economy has created new jobs and produced marvels of abundance in the past. It should be able to do so in equal or even greater degree in the future. Our population is rapidly increasing, educational levels are rising, work skills are improving, incomes are widely distributed, consumers are eager to improve their living standards, businessmen are actively engaged in starting new enterprises and expanding old ones, the tools of industry are multiplying and improving, research and technology are constantly opening up new opportunities, and our public policies generally encourage enterprise and innovation. With so many favorable factors, a continuation of rapid economic growth may reasonably be expected.

CHART 1



An arithmetical calculation, based on a number of technical assumptions, the most important being that the average annual gains in productivity that we have had in recent times will occur in the future, shows (see Chart 1) that our country can within a decade increase its production from a current annual level of about 360 billion dollars to 500 billion or more, with the figures expressed in dollars of the same buying power. Of course, the record of the past sets no limit to our future achievements. Nor should we permit arithmetical projections to obscure the basic fact that an economy succeeds only as people succeed. Our economic future depends on the full use of the great treasure house of intelligence, skill, energy, and confidence of the American people.

A glorious economic future may be ours, but it is not vouchsafed to us. We shall achieve it only by wise management of our national household. In the future as in the past, increases in productivity and in useful employment opportunities will be the core of economic expansion (see Chart 2). The tools and equipment used by farm, factory, mine, and office workers must be multiplied and improved. Industrial techniques, materials, and management must become more efficient, and skills and morale enhanced, so that the amount of production for each hour worked will increase. And unless there are satisfactory jobs for those who seek useful employment, and unless human labor is devoted increasingly to the production of goods and services that improve the quality of life, our gains in productivity may be dissipated.

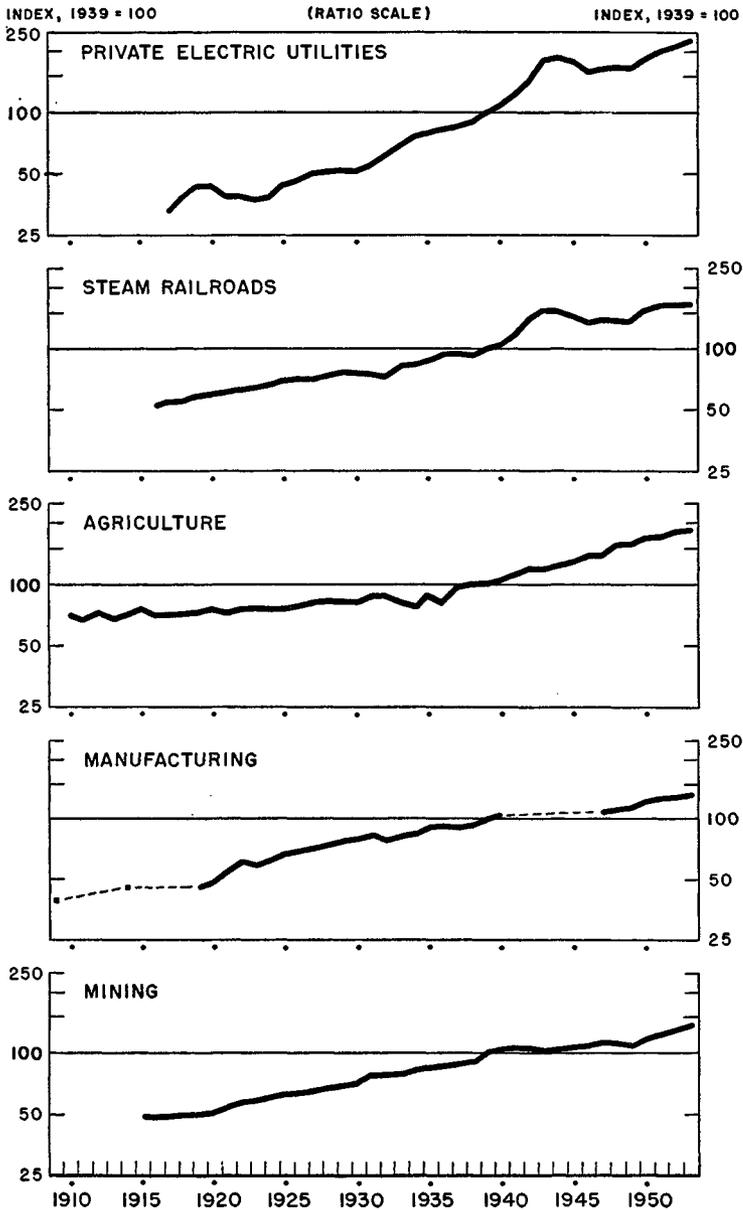
#### *Role of Government in Progress*

The history of our country, as well as of other parts of the Western World, demonstrates that economic progress depends fundamentally on the enterprise and initiative of millions of people seeking to better themselves. In such a process of economic expansion the Government can play, however, a highly constructive role. Within its own proper sphere, the Government must be ready and willing to act. Indeed, failure or reluctance to play its part can be a serious handicap to economic growth, as would a similar lack of initiative on the part of private enterprise.

Among the activities essential to economic progress and in which there is a large public interest is the field of education, extending from education for literacy to the highest reaches of theoretical inquiry. Scientific and technical knowledge, research and development programs, and industrial innovation and its diffusion are the wellsprings of an increasing output per man-hour, upon which our hopes for a better life and more leisure in the future largely depend. An enlightened public policy must therefore focus attention upon augmenting the number of young people who have scientific, engineering, and technical skills; upon encouraging creative thinking and invention; upon inducing business enterprises and nonprofit organizations to support expanding programs of research; upon enlarging the range and depth of Federal research and development programs in fields that cannot be covered adequately by private efforts; and upon hastening the industrial application of new methods and ideas through new investments.

CHART 2

# OUTPUT PER MAN-HOUR IN MAJOR INDUSTRIES, 1909-53



NOTE: BROKEN LINE CONNECTING POINTS INDICATES DATA NOT AVAILABLE FOR INTERVENING YEARS.  
SOURCE: COUNCIL OF ECONOMIC ADVISERS, BASED ON DATA FROM VARIOUS GOVERNMENT AND PRIVATE SOURCES.

Public policy must also protect incentives and encourage a spirit of enterprise and innovation among people. The man or woman who, in the hope of personal betterment, works harder, designs a new product, creates a new method, invests in a new business, moves to a new job, or suggests a new idea to his employer must believe that the rewards of initiative and effort are worth while. Through all of its policies the Government must encourage enterprising action by business managers, investors, and workers, in an environment that is kept basically free and competitive.

Economic progress entails changes in technology and commerce, and these changes require adjustments by people to new and altered ways of doing things. To insure that a dynamic economic environment involves a minimum of personal hardship and a maximum of new opportunity, governmental policies should be designed to ease the movement of people to new areas or new occupations. Through an ever wider possession of education, technical skill, and capacity for movement, new doors of economic opportunity can be opened and the remaining pockets of low income in our land can be reduced.

Expansion of private economic activity calls for great increases in the Nation's physical stock of public capital, as the Economic Report to the Congress in January 1954 pointed out. Government—State and local as well as Federal—has a responsibility to see that progress is promoted by adequate public works for education, medical care, transportation, conservation, and recreation.

The achievement of our economic goals requires that we further strengthen the floor of security for individuals and families in our industrialized society. When people have provided for minimum needs in their old age or in the event of misfortune, they are apt to become more productive and more venturesome participants in an expanding economy. A wise Government can help people to provide for these needs, without impairing their self-reliance.

A strategy for realizing our Nation's growth potential must include, as an indispensable part, measures by ourselves and others for gradually clearing the channels of trade, of payments, and of investments between nations, so that our people as well as others may devote themselves to the tasks in which they have a special advantage, and so that the Free World may be bound together by a mutually beneficial economic intercourse. Thus our Nation's security, as well as its material welfare, may be advanced.

Finally, we must continue to coordinate all governmental programs, especially monetary and fiscal policies, in order to restrain and offset any tendencies that may develop toward recession or inflation. An expanding economy requires increases in the supply of money and credit, but not on a scale that invites inflation in the present and possible depression in the future. The Federal Government should continue to manage its revenues, debts, and expenditures, and conduct its regulatory activities, so as to contribute to the expansive strength and stability of the economy.

### III. STEPS TAKEN DURING 1954 TO BUILD A STRONGER ECONOMY

During the year that has just closed, the Government has taken many steps, both legislative and administrative, to put into effect policies that augment the expansionary powers of our economy and that express the basic economic tenets set forth in this Report. These actions have helped to generate confidence in the minds of the American people.

#### *Fiscal and Monetary Actions*

The most powerful and pervasive of these actions have been of a fiscal and monetary character. The reduction in military and other outlays, which occurred after the ending of the Korean conflict, made possible sharp cuts both in taxes and in the Federal budgetary deficit (see Chart 3). Concurrently, the Federal Reserve authorities made clear their intention to maintain an adequate supply of credit at moderate cost, so long as this facilitated economic growth without inflation. These fiscal and monetary measures stimulated constructive economic attitudes and behavior on the part of consumers and businessmen. They fostered the expectation of improving economic conditions, reasonably stable prices, efficient house-keeping by Government, and tax reductions in the future. Thus, they encouraged the maintenance of a high rate of private spending, and set the stage for successful application of other governmental policies to foster long-term expansion.

#### *Enlarging the Opportunities of Competitive Enterprise*

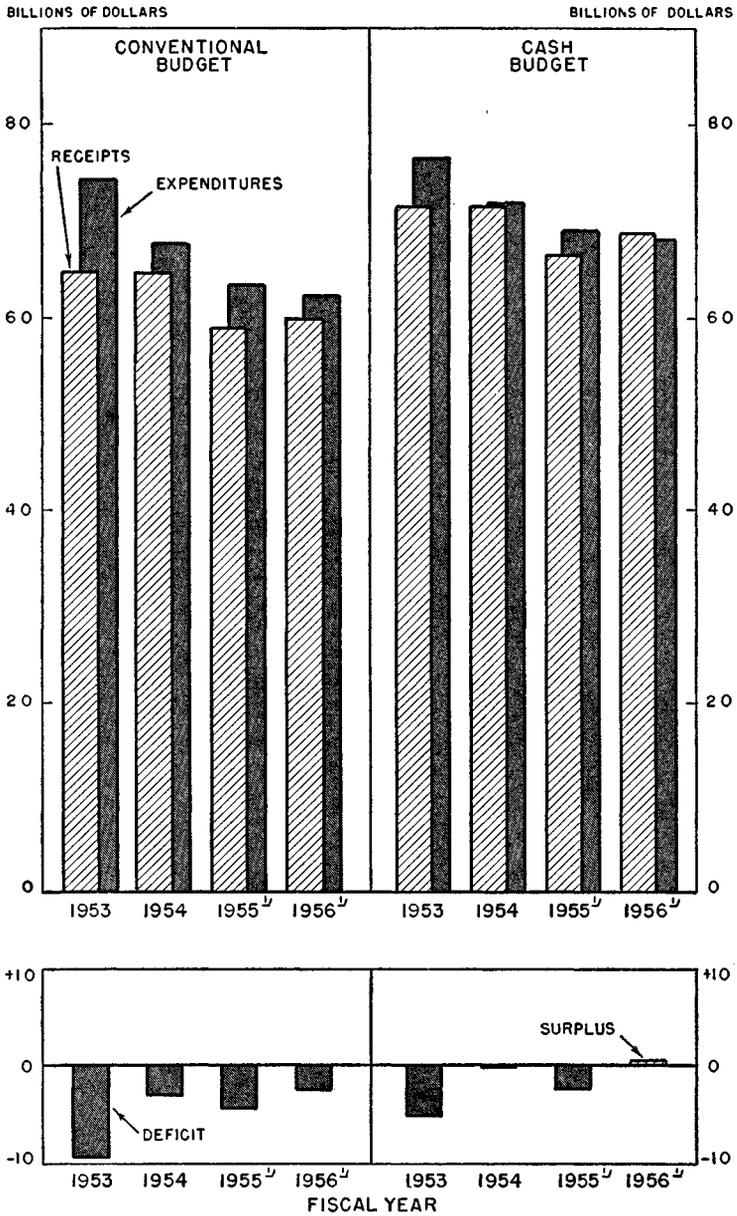
Recent actions of the Congress and the Executive have enlarged and clarified the range of private enterprise. Of great potential significance is the new law which authorizes the Atomic Energy Commission to license, with due regard to the public interest, the use of special nuclear material in privately-owned reactors, and which substantially broadens patent protection for private inventions in the atomic energy field. Opening the door to competitive enterprise in the development of nuclear power and other industrial uses of atomic energy will magnify the benefits our people are already deriving from this new resource.

The Government also made progress in redrawing the line separating private and public enterprise. Steps were taken to dispose of numerous enterprises for which public operation was inefficient or of doubtful advantage. Simultaneously, the Government increased the amount of its contracting with private firms for necessary services and facilities—as an alternative to producing them itself, often at higher cost to the taxpayer. To hasten the economic development of our water resources, and yet restrict Federal participation to what others are incapable of accomplishing, the partnership principle of Federal cooperation with local interests, public or private, was launched.

The vigor of competitive enterprise has been promoted by many changes in our laws. Thus the recent tax law liberalized depreciation allowances,

CHART 3

FEDERAL RECEIPTS AND EXPENDITURES



<sup>u</sup>ESTIMATED.

SOURCES: TREASURY DEPARTMENT AND BUREAU OF THE BUDGET.

extended the period over which business losses can be carried back for tax purposes, facilitated a ploughing back of earnings for expansion, encouraged research and development expenditures, and granted a limited tax credit on dividends received by shareholders. All of these measures should assist business firms, especially those of medium or small size, to grow and to provide new jobs at satisfactory wages. At the same time, legislation was passed to relax Federal controls over farming. The introduction of flexible price supports for basic crops and the modernization of the "parity" formula will facilitate the adjustment of our farming enterprises to changing markets and thus help improve the outlook for the farmer.

### *Strengthening Economic Ties with Other Countries*

Although action on major proposals for changes in our foreign economic policy was deferred to this year, several constructive measures to advance international trade and investment were adopted during 1954. Government controls of the export of many commodities to friendly countries were removed. The lending authority of the Export-Import Bank was increased from 4.5 billion to 5 billion dollars, and a new export-credit program was introduced to facilitate trade. Action was taken to establish uniform and reasonable standards for the application of the Buy American Act. Improvements in customs administration were made to benefit trade.

With the aim of enlarging private investment abroad, the Foreign Operations Administration extended the coverage and halved the premium charge for government insurance against expropriation or currency inconvertibility. Another advance toward the same objective was made by removing the over-all limitation on the extent to which foreign tax payments could be credited against United States income taxes, and by allowing shareholders in regulated investment companies having more than one-half their investments in foreign countries to benefit by foreign tax credits.

### *Building the Floor of Personal and Family Security*

As a result of governmental actions during the past year, many people are now better able to meet their housing needs and the problems of old age and unemployment. Over 10 million men and women were brought into our system of Old-Age and Survivors Insurance. Social security contributions were increased, but the scale of benefits paid to the aged was raised and the amount of their permissible earnings increased. At the same time, pensions and disability compensation rates for veterans were raised.

The Federal-State unemployment insurance system was also strengthened. Over 1.3 million workers in smaller firms and 2.3 million Federal civilian employees were brought into the system, thus raising the total covered population to approximately 40 million. Both the amount and the maximum duration of benefits payable under the unemployment insurance law in the District of Columbia were increased. A special Federal loan fund was established to assure uninterrupted payment of unemployment benefits by States whose reserve funds may become low. To meet acute personal

problems, provision was made for substantially larger grants to the States for vocational rehabilitation.

Important actions were also taken to extend home ownership, conserve urban neighborhoods, and speed the elimination of slums. Thus, the terms on which mortgage loans could be insured by the Federal Housing Administration were liberalized for both new and existing dwellings, and the application of mortgage insurance was extended to sale and rental housing in blighted areas. Federal grants and loan funds were provided to aid urban renewal. Along the same line, the authority of the Administrator of Veterans' Affairs to make direct home and farmhouse loans to veterans was extended, and additional funds were made available for this purpose.

### *Expansion of Public Assets*

Recognizing that the provision of public roads, schools, hospitals, and community facilities has long lagged behind our needs, the Federal Government acted last year to augment a number of public works activities. Federal highway grants to the States of 875 million dollars were authorized for each of the fiscal years 1956 and 1957, thus greatly increasing the annual amount of Federal aid previously made available. One hundred and twenty-five million dollars was made available for school construction in areas where Federal activities had affected school enrollment. Substantial aid was authorized to the States for building hospitals and other medical facilities, and was backed by an appropriation of nearly 100 million dollars for the fiscal year 1955. After many years of debate concerning the St. Lawrence Seaway, a development corporation was finally created and authorized to cooperate with a Canadian agency in the construction of the Seaway, our share of the cost to be financed on a self-liquidating basis. Apart from this, over 1 billion dollars was authorized for the construction and repair of navigation, flood control, and other civil works. Additional authorizations for military construction were made, supported by an appropriation of 817 million dollars for the fiscal year 1955. Within the same category of legislation was the authority granted to the Executive to add to the tanker fleet. Finally, important steps were taken to put advance planning of public works on a more systematic basis.

### *Plan of Report*

The effects of these and related governmental actions are considered later in this Report and its Appendices. The next chapter is devoted to a review of recent economic developments, the principal measures taken by Government to influence their course, and the prospects of the economy. This review should help us determine the next steps of a governmental policy aiming to promote a sustained and satisfactory rate of economic growth. A program of proposed governmental actions is set forth in the third and final chapter.