

Chapter 4

Economic Opportunities and Challenges Ahead

AS WE ATTEMPT to evaluate the current economic situation and the outlook for the year ahead, we must be alert to the limitations of our information concerning many factors that will influence the outcome and, above all, to the uncertainties that attend any effort to chart beforehand the course that our free economy will take. However, it seems likely that, in the current year, changes in spending by business concerns on new facilities and equipment and by Government on defense procurement will significantly influence the magnitude and duration of the movement of inventories and, in conjunction with inventory changes, the course of over-all economic activity. Accordingly, attention may usefully be directed first to these important components of the demand for goods and services.

APPRAISAL OF THE CURRENT ECONOMIC SITUATION

Although an extension into 1958 of the decline in business expenditures on plant and equipment is suggested by data on new orders and contracts, and by information on businessmen's investment intentions, the magnitude of the decline and its duration are uncertain. Decisions regarding these expenditures are influenced by a variety of conditions that affect particular industries and firms and are subject to rapid change. The outcome will be especially affected by sales experience and expectations. A decline in investment spending seldom lasts only a few months; however, in some industries reductions began as early as 1956, and in many others they have been in progress during much of 1957. Also, certain conditions that tend to limit the decline may be noted. Pressures to reduce costs and to improve products continue and in some respects have been intensified. Research and development activities, which are cumulative in their results, continue at a high level and are certain to yield many practical suggestions for undertakings the financial feasibility of which will be enhanced by the greater availability and lower cost of capital and credit.

For other categories of investment expenditures, many evidences of strength are apparent. There are signs that the rise in residential construction outlays will continue, possibly at a faster pace. Well-maintained personal incomes, greater availability of mortgage credit, and recent moves to reduce the cash investment required for home purchase will help achieve this result. Expenditures for the construction of various types of private institutional buildings have been rising for several years. Growing needs for

such facilities and the improvement in financing conditions reinforce the evidence provided by contract awards that outlays on this type of construction should continue to rise moderately.

Foreign demand, on the other hand, is likely to exert a moderately contractive influence on economic activity for the time being. The reasons for this are discussed in Chapter 3. They include the passing of the special circumstances which accounted for part of the sharp increase in United States exports in 1956 and early 1957, some slowing down in economic expansion abroad, and pressure on the foreign exchange positions of certain nations abroad. While a reduction in some categories of United States import demand is also evident, exports seem likely to decline relative to imports. This development, in conjunction with other international economic transactions, would involve a further, though probably modest, reduction in net foreign investment and hence in the stimulus provided to production and employment from this quarter.

In view of the necessary acceleration of certain defense programs, and the steps already taken to give effect to this change, national security expenditures may be expected to increase during the year ahead. Insofar as business activity is affected by the award of procurement contracts, which are being placed at an increased rate, it may rise earlier and more strongly than the prospective increase in national security expenditures.

The growing need for public services, and particularly the further increase of highway construction, point to a continued high rate of increase in the expenditures of State and local governments. The outlook for more ample and lower-cost financing strengthens this expectation.

The uncertainties associated with estimating the movement of each of these major elements of demand remain, of course, when an attempt is made to strike a balance for them taken together. Though the decline in business outlays on new plant and equipment may outweigh the combined rise in other types of investment expenditures, this is likely to be offset by the necessarily larger outlays on certain defense procurement items and by the rising expenditures of State and local governments. And the rate of inventory reduction may not be substantially greater than it has been so far, if the balance between government expenditures and business capital outlays is favorable and if personal incomes and consumption expenditures are well maintained, as seems likely.

These considerations suggest that the decline in business activity need not be prolonged, and that economic growth can be resumed without extended interruption. The policies of Government will be directed toward helping to assure this result.

THE LONGER PERSPECTIVE

At a time like the present, when the economy is adjusting to the large increases in productive capacity created in the past few years, it is well to seek a longer perspective on our economic prospects and to consider some

of the sources of strength for the years ahead. There are good grounds for confidence not only that economic growth can be resumed without prolonged delay, but also that a vigorous expansion of our economy can be sustained over the years. Our domestic market for goods and services has about doubled every quarter of a century. There is every reason to believe that we shall do at least as well in the next 25 years.

The vigorous postwar growth of population is a basic and powerful force making for expansion in the American economy. Our numbers are increasing by some 3 million a year, and there is no reason to doubt a strong uptrend in the next quarter century. In our economy, an increase in population continues to mean new and enlarged markets for output. Over the last two decades, per capita consumption has increased by more than 50 percent, in spite of changes in the age composition of the population which have tended to lower basic needs per capita for consumer goods. After this year or the next, the number in the group aged 13 to 19, whose needs and wants are much greater than those of young children, will increase substantially for a decade or more.

The growth and changed age distribution of our population will require greatly expanded private facilities for the production, transportation, and distribution of goods and for services of many kinds, including education. The capital assets normally provided by Government must at least keep pace, and the expansion of some types of public assets will have to be at a faster rate to reduce backlogs and to supply services that will be required in especially increased amounts. The clearly indicated need for enlargement of the capacity of our public schools, colleges, and universities is a case in point. Large and growing sums will be spent by State and local governments to provide needed educational and other facilities and services. Large public and private outlays will also be required to develop and conserve our water, land, forest, mineral, and energy resources. Major undertakings have been launched in many cities, with Federal aid, looking to the renewal of urban areas, and many more are in the planning stages. State and local outlays have been rising at the rate of \$3 billion a year, and something like this rate of increase must continue, to keep pace with growing requirements.

Many activities of the Federal Government exert a growth-promoting influence. Grants to States for extending and modernizing our roads and highways will reach \$1.8 billion in the current fiscal year and \$2.4 billion in the next fiscal period. The program for providing the navigational aids necessary to jet air travel and otherwise modernizing our airways will grow in magnitude over the next several years. Major improvements will be called for in the great variety of physical facilities utilized by the Federal Government. Like the vast improvements in public assets being undertaken by State and local governments, these Federal programs are designed to keep pace with expanding public needs and to facilitate the long-term expansion of our private economy. These additions to the Nation's assets

will have an economic effect many times their direct cost through the new opportunities for profitable private investment which they will inevitably open up.

A further element of strength consists in the increase of knowledge and the improvement of technology which are being steadily fostered by a huge expansion of our educational system and of research and development. Billions of dollars are being spent each year by private industry and institutions on scientific and technical research, and additional billions by the Federal Government. These efforts, including many federally supported projects related to national defense, will lead to new products for civilian use and improved methods of production. Indeed, a large proportion of our output in 1957 consisted of products not in use a decade or so ago. There is every reason to expect continuation of these trends in the years ahead.

It can be safely anticipated that the momentum of economic development, which has been a notable feature of recent years in most of the advanced countries of the world and in several of the less advanced, will be resumed as readjustments now in progress are completed. The extent of international economic cooperation among the free nations of the world exceeds anything heretofore experienced, and recent steps toward greater economic integration in Western Europe hold out high promise. Almost everywhere, horizons have been extended and greatly enlarged economic potentials are recognized. In this perspective, the temporary strains now being felt in some countries and the more basic problems of others can be faced with more assurance.

Important developments in recent years have significantly improved the outlook for greater stability in our economy. Among these are the substantial progress of market and economic research by American businesses, and the more orderly and longer-range planning which they now undertake for the expansion and improvement of their productive facilities. Businesses can usefully intensify these activities. In large part because of them, it is less likely now than in earlier years that unsound projects will be launched in a boom psychology, or that projects needed for the long pull will be discontinued in a period of readjustment.

The stability of our economy is also enhanced by public and private arrangements, greatly extended in recent years, that help maintain incomes in an economic downturn. The Federal-State unemployment compensation system is functioning with enlarged coverage and somewhat liberalized benefits. The broadened coverage of old age, survivors, and disability insurance and the increasing volume of payments sustain the purchasing power of many millions of consumers. Benefits are also paid in an increasing volume to many millions of persons under private pension and welfare programs. Under our tax system, income tax liabilities vary directly with individual and corporate income, so that incomes change less after tax than before tax. Such stabilizers cushion the impact of an economic decline and improve the basis for early resumption of growth.

The strength of our financial institutions provides a basis for confidence both in immediate economic prospects and in the outlook for economic growth over the longer run. Speculative excesses have been notably rare in our recent experience. Though consumer debt is higher than ever before, it is not dangerously burdensome in a growing economy. The prevalence of regularly scheduled debt repayment, both on long-term mortgage indebtedness and on shorter-term obligations, reduces the risk of defaults. A far greater proportion than ever before of the assets of financial institutions is protected by governmental insurance or guaranty; and the guaranty of liabilities to depositors covers virtually all of our banks.

Assured of these continuing sources of economic and financial strength and stability, business concerns and consumers can make plans which will enable the Nation to move forward to new economic achievements.

The latest challenge of international communism will require a further increase in the economic claims of national security, which are already heavy. If we follow suitable private and public policies, this challenge can be met without distorting our economy, or destroying the freedoms that we cherish. Whatever our national security requires, our economy can provide and we can afford to pay.

THE CHALLENGE TO ECONOMIC POLICIES

Although a realistic appraisal of the present economic outlook warrants confidence, it also requires that we recognize an unfavorable feature of the recent performance of our economy. In 1957, the money value of gross national output rose by almost 5 percent, but in physical terms the increase was only about 1 percent. There was a good expansion in demand but, despite the existence of unused capacity in several important lines of industry, it was accompanied by an increase in prices and only a small increase in output. At the same time, the margin between business costs and prices narrowed, business profits were reduced, and at the end of the year production and employment were declining.

There is no simple explanation of recent economic developments and no easy solution to the problem of maintaining high employment, vigorous economic growth, and reasonably stable prices. But it is clear that the combination of policies and practices followed in the recent past by the various participants in our economic life has given results that in certain important respects are unfavorable.

There are critical questions here for the leadership of business and labor, as well as for Government. Business concerns must re-examine their policies and practices. Price increases that are unwarranted by costs or that attempt to recapture investment outlays too quickly not only lower the purchasing power of the dollar but may be self-defeating by causing a restriction of markets, lower output, under-utilization of capacity, and a narrowing of the return on capital investment. The leadership of labor must recognize that

wage increases that go beyond prospective productivity gains are inconsistent with a stable price level. The problem of inflation can only be aggravated by wage increases that are demanded and obtained on the assumption that living costs are going to rise; and the resumption of economic growth can only be slowed by wage demands that imply either an increase in prices or a further narrowing of the margin between prices and costs. Government's role is to follow policies that will help keep our economy stable and promote sound economic growth with reasonably stable prices.

The resumption and maintenance of economic growth which can be achieved through suitable private and public policies assure expanding economic strength with which to meet the Nation's needs, accomplished through an enterprise system that preserves individual freedoms. However, if this opportunity is to be fully realized, economic growth must take the form of increases in real output, accompanied by a stable price level. This can be achieved if weight is given to long-run as well as short-run considerations in policies and practices that affect our economic welfare. It can be guaranteed by a public opinion that is alert to the consequences of wrong policies and insists on those that will yield real economic growth without inflation.