Chapter 1

Economic Goals and Policies in a Free Society

DEVELOPMENTS IN 1957 illustrate how rapidly changes can occur in the problem of maintaining growth with reasonable stability of prices in a dynamic, free enterprise economy. Production, employment, and income were high, but tended to decline somewhat toward the year's end. During much of the year, a rise in the consumer price index accompanied a slowing down in the rate of growth of national output. Small increases in the price index continued even after industrial production and employment had turned downward and inflationary pressures had been substantially diminished. In recent months, fresh challenges have arisen: to strengthen our defenses; to improve our position in science and education; and to unite our efforts more effectively with those of other countries for the achievement of security, freedom, and improvements in material welfare.

These changes, compressed into a short time span, underscore the need for a balanced conception of national economic goals, if private and public policies and programs are to serve all our people and advance the long-run as well as the immediate interests of the Nation. We cannot say that we have only one goal, unless it is to advance the general welfare. Sustainable and balanced growth in our economy is needed to assure our defenses, to satisfy our growing wants, and to enable us to assist healthy expansion and improvement in other economies of the free world. Also, we seek to hold economic fluctuations within narrow limits, to maintain a reasonably stable price level, and to avoid deflationary as well as inflationary developments. And we insist on striving for these goals within a framework of free competitive institutions.

To achieve a proper balance among these sometimes conflicting objectives is a difficult task. Success requires an understanding by all of us of our national economic objectives and of private and public responsibilities for helping achieve them. Accordingly, this chapter is devoted to a statement of these objectives and a brief review of the steps taken during the year to attain them.

Economic Growth

Confidence that economic growth and improvement within a framework of free institutions are feasible national goals is evidenced by the stress which the Employment Act of 1946 places on "maximum production, employment, and purchasing power." The record of the 12 years that have elapsed since the Employment Act was passed has abundantly justified this confidence and clearly demonstrated the strength of the forces that make for growth in a free economy. A rising national output has enabled us to make up arrears that accumulated during the War. Most of the heavy requirements arising from the increase in our population and the persistently expanding needs and wants of our people are being met. We are also fulfilling greatly enlarged world responsibilities.

The aggregate of goods and services produced today is nearly one and a half times what it was when the Employment Act was passed. This is an average rate of economic growth of 3½ percent a year. There are 10 million more civilian jobs now than there were in 1946. More than $350 billion of private funds have been devoted since then to the expansion and modernization of productive facilities. In addition, huge investments have been made in housing, schools, hospitals, roads, and other private and public improvements.

The use of these vast resources to increase our productive capacity and our fixed public and private assets has been accompanied by a sustained advance in current consumption. The output of consumer goods and services is 40 percent higher today than it was in 1946. The increase over the period has averaged about 3 percent a year.

In short, our economy has exhibited a remarkable capacity for sustained and balanced growth. The American people and the free enterprise system have responded well to the challenges of our increasing requirements.

These challenges continue. In some important respects they have become greater. Despite our utmost efforts, international tensions persist. This hard fact emphasizes the need for a sound and growing economy to assure our defenses. The national security burden carried by our economy is a heavy one, claiming about 10 percent of our national output. We do not abandon hope for arrangements under which less of our own and of the rest of the world's resources can, with safety, be devoted to military preparedness. But pending measurable progress in these efforts, Americans will not shrink from the task of defending our freedoms, whatever the necessary cost.

A sound and growing economy is needed also to meet the requirements of our expanding population. There are 32 million more Americans now than at the end of World War II, and the number is increasing at the rate of about 3 million a year. Heavy economic requirements are implied by this increase. A huge expansion of educational personnel and physical facilities will be required to train increasing numbers of students for the higher level of technology on which our security and welfare depend. Our larger population will also require increased facilities for the production and distribution of goods and services, and for health and recreation. Production must expand as fast as population merely to maintain our present consumption standards. Even higher rates will be necessary as these standards rise.

Apart from our civilian and defense requirements, economic growth is needed to help meet our expanded international responsibilities. These include the provision of public and private capital to assist economic development abroad, as well as military and economic aid to countries associated with us in the common defense effort.

Although the rate of economic growth that is best suited to the Nation's capacity and requirements cannot be stated precisely, the low current rate would clearly be unsatisfactory as a continuing condition. We must always be alert to question the adequacy of the rate of economic growth and to consider whether further encouragement and incentives are needed, and if so how best to provide them. Yet we must be continuously on guard against resort to measures that might provide a spurt in activity at the cost of impairing the long-run health of the economy.

Economic Stability

When the Employment Act was being considered in the Congress, fears were expressed that the transition from war to peace would entail serious economic dislocation and abnormally high unemployment. Actually, the transition was made with relatively little contraction in production, employment, or income, despite the large reductions in national security expenditures. The supporters of the legislation were also mindful of the waste of resources which economic fluctuations had occasioned in the past. The Council of Economic Advisers was accordingly directed by the Employment Act to develop and recommend to the President national economic policies "to avoid economic fluctuations or to diminish the effects thereof."

Economic stability as an aim of national policy clearly means more than fostering the maintenance of production, employment, and income at constant levels. Extended lapses from normal rates of growth must be resisted and their effects diminished where possible. And every effort should be made to moderate surges that go beyond rates of growth that can be sustained over longer periods. Such surges often involve increases in limited sectors of the economy that cannot be sustained and that may lead to serious imbalances. The proper objective of national economic policy, to the achievement of which private as well as public actions must contribute, is to strive to limit fluctuations in the rate of over-all economic growth to a relatively narrow range around a rising trend.

Because our economy responds to forces and conditions that are continually changing in intensity and character, economic growth will inevitably proceed at a somewhat uneven pace. The high rate of economic growth that occurs when ground lost during a recession is being recovered cannot continue indefinitely. When economic resources are close to being fully used, even though there may be slack in some sectors of the economy, expansion normally proceeds at a slower pace. Efforts to accelerate growth under these conditions may succeed only in generating inflationary pressures.

When readjustments are being made, with some sectors of the economy remaining unchanged or contracting while others are expanding, over-all economic activity may show no growth for a time, or may even recede slightly. The establishment of a new balance which such a readjustment entails is often an essential phase in the operation of a dynamic enterprise system. It is the means by which the economy corrects previous excesses and prepares for resumption of over-all growth. Through its economic policies and programs, Government can help achieve this improved balance and speed the resumption of sound economic growth.

Price Stability

A clear responsibility rests on Government to pursue policies that will help prevent inflation. Although the harmful consequences of inflation spread widely through the economy, they fall with unequal severity on different individuals and on different economic sectors. Some persons may obtain an increase in money income that is greater than the increase in living costs, while others may fail to do so. Some industries may be in a better position than others to adjust prices promptly to rising costs. As a result, the relative economic positions of individuals and of different industries may be altered, sometimes in ways that harm the national welfare by lessening incentives to enter certain essential vocations and by impeding the flow of resources into important sectors of industry. Similarly, although the investment income of some individuals may rise during an inflationary period, that of others, and frequently the great majority of those who have only modest savings, does not increase at all. Consequently, persons in the latter group suffer a decline in the value of the income received and a diminished purchasing power of their savings when repaid. The effect is to reduce the incentive to save, which tends to dry up one of the major sources of capital upon which maximum employment and economic growth depend. Furthermore, price inflation directs activities into speculative channels and distorts private and public obligations and contracts that are expressed in fixed dollar amounts. Finally, changes in the value of money disrupt international trade and financial relations. In these and other ways, inflation weakens our capacity to achieve and sustain balanced economic growth.

The task of restraining price inflation is a continuing one for a free society experiencing high production, employment, and incomes over long periods. In such a society, pressure on prices may arise from a number of sources. One is the rapid increase and concentration of demands on scarce skills and resources and on output which is limited by capacity. Another is the exuberance, even imprudence, of some individuals and businesses during good times in making commitments that assume continual inflation in prices. Still another is the exercise of economic power by individuals and groups favored by temporary conditions or by their place in the Nation's productive system.

We must learn to conduct our economic affairs in ways that will harness the expansionary forces of our free economy for the increase of our national strength and well-being, and must prevent these forces from finding expression in a depreciation in the value of our money. This task entails heavy responsibilities for private individuals and groups, and for Government, to pursue policies that will assure that economic expansion provides an increase in real output and does not consist merely of larger money values reflecting higher prices. A strong and growing economy is needed for our national security, for meeting the needs of our expanding population, and for improving our level of living. Reasonable stability of prices is needed also, for reasons of equity and as a condition for sustaining economic growth. Failure to achieve these goals would court the danger of controls incompatible with our way of life which would eventually impede advances in our economic welfare.

Free Competitive Enterprise

The productiveness of the American economy derives from its reliance on private enterprise and on the incentives and opportunities which such a system supplies for the development and use of individual talents and energies. Initiative and efficiency are stimulated and rewarded through the market place; pressures are exerted to remedy inefficiencies; and economic resources tend to be used in accordance with the preferences of consumers. This way of organizing production and consumption both encourages vigorous economic growth and reinforces our freedoms in the political and social spheres. Thus, the strengthening of free competitive enterprise not only is a means for promoting economic growth but also is, in itself, a major objective of policy.

This view was held by the authors of the Employment Act, who made it explicit that Government, in seeking to achieve maximum production, employment, and purchasing power, should do so "in a manner calculated to foster and promote free competitive enterprise." Accordingly, in our efforts to achieve economic growth and at the same time to avoid price inflation, we place reliance on measures that involve a minimum of direct intervention in the affairs of individuals and private groups. The corollary of this reliance is that the policies and practices of individuals and private groups must contribute to, not hinder, the achievement of economic growth with reasonably stable prices. With such assistance toward making the joint effort a success, pressures for direct Government controls are averted.

Economic Change and Shifts in the Emphasis of Policy

No one goal alone provides a complete guide to public policy in economic matters. In an economy where changes are as rapid and far-reaching as those which occur in ours, the accent of policy shifts according to the logic of events. At times the emphasis may be mainly on the containment and reduction of inflationary pressures, which has been the case during much of the period since 1955. At other times, as at present, the accent may properly be placed on encouraging orderly readjustment within the economy and facilitating the resumption of economic growth. At all times, policy must be capable of responding to unusual demands, such as those that have been felt recently as a result of international developments.

Economic Policies in 1957

In 1957, policy had to cope with important changes in the economy. The paramount task during much of the year was to restrain inflationary tendencies. However, as the year developed, these tendencies diminished in strength. Current demand failed to keep pace with growing industrial capacity in a number of lines. Shortages of goods became fewer and were largely eliminated after the middle of the year. Prices of basic commodities began to decline in the early months, and the rise in prices of finished industrial commodities was moderated. The index of consumer prices, however, which had started to rise in April 1956, continued upward with only brief pauses. In the late summer, production, employment, and sales leveled off or declined in a number of lines; and as the year closed, indicators of over-all economic activity moved down in response to the using up of inventories and to somewhat lower domestic and foreign sales.

This shifting of economic forces called for adjustments in public policies. For the first three quarters of the year, Federal Reserve operations were designed to limit the expansion of bank credit and to hold down increases in the money supply. A partly seasonal reduction of $1.6 billion in Federal Reserve holdings of Government securities kept the reserve position of member banks under continuous pressure. The pressure on reserves induced member banks, despite an increased discount rate, to borrow more heavily from the Federal Reserve System. From April through mid-October, member bank borrowings fluctuated around $1 billion, and net free reserves (the difference between excess reserves and member bank borrowings) remained negative, at close to $500 million.

These restrictive measures had a marked effect on the money supply and, jointly with the heavy demand for capital and credit, on interest rates. Demand deposits, the most important component of the money supply, were virtually the same at the end of 1957 as two years earlier. During the same period, the dollar volume of total output increased 7 percent. With demands for capital and credit continuing substantial, and the supply of funds under increasing pressure, interest rates rose sharply in the first half of 1957. In August and September, the costs of financing for corporations and State and local governments were well above anything experienced for many years. By mid-October, the yield on long-term Government securities had reached 3.78 percent, and the cost to the Federal Government of its shortest term borrowing had risen to 3.66 percent, the highest in 24 years.

Federal fiscal policies were also directed to restraining inflationary tendencies. Beginning early in the year, all Federal expenditure programs were closely reviewed to effect economies wherever such action was consistent with essential program objectives. No general reduction of taxes was undertaken, and reductions in specific taxes—certain excise taxes and the tax rate on corporate income—that were scheduled to occur on April 1, 1957 were postponed. The Federal budget was balanced during the calendar year 1957, and $1.7 billion of debt was retired.

Treasury financing operations were designed to help sustain economic growth and at the same time to produce a better debt structure. More than $10 billion of the Treasury's new marketable offerings had a maturity in excess of 1 year; Treasury notes varying in maturity from 3 to 5 years were offered on six different occasions; and more than $500 million of long-term bonds were issued in October and again in December. The effective rates of interest to maturity on Series E and H Savings Bonds were raised to 3¼ percent, as of February 1, 1957, to encourage saving in these forms; sales of Series J and K Savings Bonds were discontinued on April 30, 1957, in view of the high rate of redemption of these fixed-interest securities.

A number of steps were taken to moderate the impact on specific sectors of the economy of the general measures to restrain inflationary tendencies. On March 29, 1957, in two moves designed to assist prospective home buyers, the Federal Housing Administration (FHA) reduced its minimum downpayment requirements to the limit then permitted by law, and the Federal Home Loan Bank System undertook to encourage greater mobility of mortgage funds among different areas of the country by authorizing insured member institutions to buy and sell participating interests of up to 50 percent in home mortgage loans. In May, the Veterans Administration (VA) began the immediate processing of direct loan applications for veterans living in localities where private lenders had restricted their participation in the VA Home Loan Guaranty Program. On August 6, FHA reduced downpayment requirements by the full amount authorized by the Housing Act of 1957 and, in order to attract additional funds into home financing, raised the maximum interest rate to 5¼ percent.

Other actions were taken by FHA to simplify and expedite the processing of home purchase applications in remote areas, and the insurance premium on repair and modernization loans was reduced. For the year as a whole, about $1 billion of home mortgages were purchased by the Federal National Mortgage Association in its secondary market operations, in order to relieve particularly acute shortages of available funds.

Although business needs for credit were generally met well by banks and other private financial institutions, financing assistance from the Small Business Administration proved useful in helping to satisfy the special needs of many small concerns. During 1957, this agency approved $162 million of loans, 33 percent above its 1956 volume.

The credit policy of the Federal Reserve authorities continued unchanged until mid-October. By that time, mainly because of a fall in the demand for loans, member bank borrowings at the Federal Reserve Banks began to decline, and the net deficiency of reserves gradually fell. All but one of the Federal Reserve Banks reduced their discount rates from 3½ percent to 3 percent between November 15 and November 29, initiating a decline in interest rates and bond yields. A further absorption of the net reserve deficiency occurred in December. In the last week of the year, excess reserves were greater than member bank borrowings by $74 million. Interest rates and bond yields had returned to approximately the levels reached in late 1956 and early 1957.

Increasing the availability and lowering the cost of credit are measures that help moderate a decline in business investment. They also permit capital outlays by State and local governments that might not otherwise be feasible. Largely through their impact on the yields available on corporate securities and Government obligations, they widen the spread between the return on home mortgages and on competing uses of funds. They tend thereby to make financing more readily available for home construction and purchase and to promote a higher level of building activity. Their effectiveness in this connection was strengthened in January 1958 by actions taken by Federal housing and home financing agencies. The Federal Housing Administration announced the rescinding of a rule, adopted in April 1955 as an anti-inflationary measure, that prohibited the inclusion of closing costs in the maximum insurable amount of home mortgage loans. FHA also announced certain changes in the permissible discounts on insured mortgage loans, calculated to make funds more readily available in areas of the country still experiencing a relative scarcity and to bring the yield on insured mortgage investments more nearly into alignment with market rates in areas having more adequate supplies. At the same time, the prices at which the Federal National Mortgage Association buys mortgages were adjusted, also to increase the availability of funds for home construction and purchase.

In 1957, steps were taken to expedite activity in certain Federal construction programs involving no direct capital charge on the budget, and to accomplish a needed expansion of the military housing program. These moves were made with full realization of the fact that resources of labor and materials in some parts of the economy continued relatively short, particularly in construction, and that a sharp increase in demand might result in further increases in costs and prices. For this reason, they were taken cautiously, to avoid reviving inflationary pressures in the face of enlarged national security requirements. At the turn of the year, the economy was beginning to feel the effects of an acceleration of the placement of defense contract awards, prompted by the need to move forward quickly with programs essential to the strengthening of the Nation's defenses.

Events in 1957 show how important it is for private and public policies and practices to complement each other as we seek to achieve economic growth with reasonable stability of prices. Decisions which give rise to wage increases generally in excess of improvements in productivity, or to price increases that typically go beyond increases in costs, make this task more difficult. If fiscal and credit policies are sufficiently stern to keep the price level from rising, there are risks of economic dislocation, an unnecessarily slow rate of economic growth, and extreme and inequitable pressures on some who are not themselves contributors to the inflation of costs and prices. On the other hand, if economically unwarranted increases in wage rates or prices are validated by credit and fiscal policies, a persistent decline in the value of the dollar results.

Neither of these is an acceptable alternative, and neither is consistent with sustainable expansion of the economy. The conclusion is inescapable that, if we are to have orderly and adequately rapid growth in the economy, our wage-making and price-making arrangements must produce results consistent with a reasonably stable price level. They must do so within a free competitive economy. Freedom, including economic freedom, requires self-discipline. If important groups ignore this truth, the alternatives are either an economy damaged by inflation or controls that are incompatible with our free competitive institutions.