Chapter 1

The Lessons of Recession and Recovery in 1957–58

WHEN THE ECONOMIC REPORT was submitted to the Congress in January 1958, the American economy was in a recession that had started about six months earlier. The decline was still moderate, but it was gaining momentum and spreading to additional areas of the economy. The Economic Report gave an account of the recession as it had developed to the turn of the year, and expressed the view that the underlying strength and regenerative powers of our free competitive system, supported by appropriate private and public policies, might be expected to bring the decline to an end soon and to restore the economy to an upward path. The recession did, in fact, halt in April 1958. By May, a recovery was under way; and before many months had passed, most of the ground lost during the decline had been regained. As 1958 ended, we were moving toward new high levels of production and employment.

The present Economic Report therefore reviews the greater part of a full economic cycle. Chapter 2 describes the extent of the contraction and how it started, what helped to keep it within narrow limits, how recovery began and developed, and what the economic situation was at the end of the year. Chapter 3 summarizes the Government actions that helped to shorten the decline, to reduce the severity of its impact, and to promote a sound recovery. And Chapter 4 proposes a program for promoting economic growth on a sustainable, inflation-free basis.

These major divisions of the Report are presented in fulfillment of the explicit requirements of the Employment Act of 1946. But it is useful also to consider what broad lessons may be learned from the events of the past year and a half as guides for the future. What do these events tell us about how our economy responds to contractive influences, about the role that Government can usefully play in seeking to moderate economic fluctuations, and about the problems that Americans must face in the years ahead in striving to achieve high and sustainable rates of economic growth, unmarred by inflation? These questions are treated in the present chapter.

The Economy's Capacity to Resist Recession

In many respects, the most important lesson taught by the recent recession is that a competitive economic system has remarkable power to resist contractive pressures and, without an extended interruption of growth, to stage a good recovery. The inherent features of our economy that make this possible—its strength and resiliency—are due mainly to our free competitive institutions, to the stability of our institutions of saving, banking, and finance, and to the character of our people, notably their industry and resourcefulness and their capacity to take a confident and balanced view of the Nation's economic prospects. Other sources of strength are due to certain long-term, structural changes in our economy—which have resulted in growing percentages of American workers being employed in industries and occupations not readily affected by an economic downturn—and to certain changes in business practices, notably long-term planning for the enlargement of operations.

Our economy is also aided in resisting recession by features that tend to moderate the impact of a decline in economic activity on the flow of income to individuals and thus on the volume of spending for consumption. The most important of these is the Federal-State unemployment insurance system, under which payments are made to individuals out of work. In addition, our system of graduated personal income taxes cushions the impact of an over-all decline in income on the amounts available for spending on consumer goods and for savings.

These features of our economy, which were clearly evident in the 1957–58 recession, have certain implications for public policy that are worthy of special note. First, the capacity of our economy to withstand contractive influences provides time for regenerative processes to make the adjustments needed for sound recovery, and for the counteractive measures taken by Government, jointly with factors making for long-term growth, to make their effects felt. Where necessary, efforts should be made to strengthen these features of our economic system.

Second, the major emphasis of Federal countercyclical policy should be placed on measures that will result in prompt action to help promote a shift in the balance of economic forces from contraction to recovery and growth. Though a useful contribution can be made by the acceleration of public works projects that are already under way or are ready to be started, little reliance can be placed on large undertakings which, however useful they may be in the longer term, can be put into operation only after an extended interval of planning. By the time they are fully under way, they may exert excessive demand on an economy that has already recovered.

Third, in contrast to large-scale public works, monetary and credit policy, used vigorously, can produce prompt and significantly helpful results. Although the easing of credit does not affect all parts of the economy to the same degree, it works broadly, is promptly reversible, and makes its impact felt without entailing direct governmental intervention in the affairs of business concerns and individuals.

Finally, the capacity to resist short-term fluctuations can be increased by Government actions to strengthen the factors that make for long-term economic growth—vigorously competitive markets, research and development activity, and heightened incentives for all Americans to work, save, and invest. It is on these factors that we depend most heavily for the thrust that lifts the economy from recession to recovery and for the stimulus to continuing economic expansion and improvement.

Policy Implications of Differences Among Economic Cycles

Although all economic cycles have certain common characteristics, each is unique in character and follows a course that varies in significant respects from its predecessors. These distinctive characteristics must be taken into account when governmental policies intended to help reverse a recessionary trend are formulated.

The need to do this was especially evident in the 1957–58 recession. It had been preceded by a major expansion in productive capacity without a corresponding increase in utilization, so that when the downturn began there was ample, if not temporarily excess, capacity in a number of important industries. In contrast, the expansion of capacity prior to the 1953 downturn had been matched by a roughly equivalent increase in production. Similarly, the American consumers' requirements for a broad range of goods were more nearly satisfied when business activity turned down in 1957 than they had been when activity began to recede in 1953. Sales of automobiles reached an exceptionally high level in 1955, aided by a sharp easing of instalment credit terms. In 1953–54, production of Western European nations was expanding rapidly, world commodity prices were relatively stable, and international trade was continuing to rise. In 1957–58, on the other hand, industrial activity in Western Europe tended to level off, commodity prices weakened, and international trade turned downward for the time being.

These differences naturally affected the character and extent of the recent decline. Business expenditures for new plant and equipment, which had fallen only 11 percent in 1953–55, dropped 22 percent in 1957–58. Total consumer expenditures were virtually stable in both periods; but in the nine months following the 1957 peak, automobile production fell 47 percent, compared with an 11 percent decline following the economic downturn in 1953. Merchandise exports, which had increased 18 percent in 1953–54, fell by about that amount in the 1957–58 recession.

But from the viewpoint of public policy, the most significant difference between the two periods was in Federal fiscal operations. In the three quarters following the 1957 peak of activity, Federal purchases of goods and services increased $1 billion, measured on an annual rate basis; in the comparable period of 1953–54, they fell $6 billion, largely as a result of the termination of the Korean conflict. This critical difference was accentuated by the fact that, although State and local government purchases of goods and services were rising in both recessions, they rose more in 1957–58 than in 1953–54. It was clear in January 1958 that even without a general tax reduction the fiscal operations of the Federal Government would have a significantly more expansive effect on the economy than they had had during the 1953–54 recession, notwithstanding the tax cut of $7.5 billion in early 1954. As it turned out, the economy received an even larger stimulus from Federal fiscal operations in the fiscal year 1958 than had been expected at first. And this effect has been intensified in the fiscal year 1959.

These facts are a reminder that there is no single prescription for corrective action which can be applied with only minor variations in every cyclical episode. They emphasize the importance, in a situation in which powerful corrective forces are already at work, of avoiding hasty and disproportionate actions, such as tax reductions that needlessly endanger the prospects of future fiscal balance and prejudice the orderly revision of the tax structure. Clearly, the distinctive features of a downturn are pertinent not only to an appraisal of the probable course of business activity as contraction develops but also to the design of measures to help stem the downturn and promote recovery.

Achieving Vigorous and Sustainable Economic Growth

We may justifiably take satisfaction in the increases already achieved in employment, production, and incomes and in the fact that the price level has been reasonably steady of late.

Our objective now must be to establish a firm foundation for extending this economic advance and price stability into the months and years ahead. But this will not come about automatically. On that point, history is clear. Action is required on many fronts, by all groups in our society, and by all units of government.

First, we must zealously safeguard and improve the institutions of our free and competitive economy. America's unassailable economic strength derives in no small measure from the fact that over the years there have been incentives and freedom to do new things and to challenge old and established ways. Our strength comes in large part from the pressures which this competition entails. Measures to shelter groups from these pressures and from the need to make the readjustments that they compel come at the cost of limiting our capacity to grow.

Second, a high rate of growth in our economy requires that we wage a relentless battle against impediments to the full and most effective use of our human and technological resources. Such impediments curb the productivity of our work force and increase production costs. They raise the prices of the things we buy and limit the success of our efforts to lift levels of living.

Third, if we are to achieve a rapid rate of economic growth and improvement in the years ahead, we must continue to enlarge and improve the plant and equipment that supplement human effort and make it increasingly productive. There must be strong incentives for businesses to commit ever larger sums for expanding their operations and reducing their costs. And there must also be incentives for the thrift essential to the financing of these critically important outlays. Policies that weaken these incentives will cause us to fall short of achieving our full potential for expansion.

Finally, an indispensable condition for achieving vigorous and continuing economic growth is firm confidence that the value of the dollar will be reasonably stable in the years ahead. In recent months, prices generally have moved within a narrow range, and some of the price increases early in the year were the result of temporary conditions, such as the effect of adverse weather on food supplies. But these facts provide no basis for complacency regarding the long-term problem of maintaining reasonably stable prices. Despite recession during the first part of the year, wage rates continued to move upward. The rate of increase was nearly as great as in periods of economic expansion, and higher than the rate at which gains in productivity have been achieved in our economy over extended periods of time. Obviously, if we have only limited success in restraining increases in unit costs during recession, much remains to be done to achieve a basis for holding prices reasonably steady when productive capacity is more fully utilized. To this challenge everyone must respond.

The individual consumer can play an important part by shopping carefully for price and quality. In this way, the American housekeeper can be a powerful force for holding down the cost of living and strengthening the principle that good values and good prices make good business.

Businessmen must redouble their efforts. They must wage a ceaseless war against costs. Production must be on the most economical basis possible. The importance of wide and growing markets must be borne in mind in setting prices. Expanded markets, in themselves, promise economies that help keep costs and prices in check.

Leaders of labor unions, in view of the great power lodged in their hands, have a particularly critical role to play. Their economic actions must reflect awareness that stability of prices is an essential condition of sustainable economic growth and that the only road to greater material well-being for the Nation lies in the fullest possible realization of our productivity potential. This requires not only that our resources be fully employed, but that arbitrary restraints on their most effective utilization be removed. We can realize more from our economy only to the extent that we produce more.

It is not the function of Government in our society to establish the terms of contracts between labor and management; yet it must be recognized that the public has a vital interest in these agreements. Increases in money wages and other compensation not justified by the productivity performance of the economy are inevitably inflationary. They impose severe hardships on those whose incomes are not enlarged. They jeopardize the capacity of the economy to create jobs for the expanding labor force. They endanger present jobs by limiting markets at home and impairing our capacity to compete in markets abroad. In short, they are, in the end, self-defeating.

Self-discipline and restraint are essential if agreements consistent with a reasonable stability of prices are to be reached within the framework of the

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free competitive institutions on which we rely heavily for the improvement of our material welfare. If the desired results cannot be achieved under our arrangements for determining wages and prices, the alternatives are either inflation, which would damage our economy and work hardships on millions of Americans, or controls, which are alien to our traditional way of life and which would be an obstacle to the Nation's economic growth and improvement.

Government also has a vitally important part to play in helping to prevent inflationary developments. First, through the management of its fiscal affairs, it can help to create an environment favorable to the achievement and maintenance of price stability. Second, to the extent consistent with other national objectives, it must strive to operate those Government programs that directly affect costs and prices in a way that will contribute to over-all price stability. Third, it must lose no opportunity, through revisions of its tax structure or by other means, to promote improvements in productivity and to provide greater incentives for economic expansion.

Numerous elements in the program recommended to the Congress in Chapter 4 of this Report are concerned explicitly with establishing a more secure basis for the price stability essential for orderly economic expansion. Other parts of the program, though immediately directed to other goals, will also further this objective. All of our people, in view of their broad common interest in economic growth, can fully support this program.