Chapter 1

The Economic Record and Its Challenge

THE UNITED STATES is currently in the midst of its fourth postwar recovery—a recovery which began in February 1961 and has now run for almost 2 years. This recovery is notable in that for the first time since the war we have made important progress toward all of our major economic goals: we have made significant advances toward the goals of fuller employment and faster growth at the same time that we have avoided inflation and achieved substantial improvement in our balance of payments position. And these gains have been accompanied by the continued strengthening of free competitive markets and continued progress toward greater equality of economic opportunity.

But in the present expansion, the economy has faced the problem of recovering from not one but two recessions—for the recession of 1960 followed an incomplete recovery from the 1957–58 recession. Despite the gains of the past 2 years, the economy has not yet regained full use of its labor and capital resources. Moreover, the progress made during the current recovery was most rapid in 1961; although advances continued throughout 1962, the rate of expansion was markedly slower. The forces responsible for slowing the expansion in 1962 threaten to prolong the period of economic slack. As 1963 begins, too many workers remain without jobs; too many machines continue idle; too much output goes unrealized as our economy runs below its potential.

The challenge and the opportunity for the American economy are to move from this situation of continuing slack to one which calls forth the full participation of a rapidly growing labor force and the introduction of fruitful technological developments. It is in this setting of promising change that we must consider our commitment to the goals of the Employment Act.

In this chapter we first review the record of 1962 and of the 1961–62 expansion. Then, to draw from the experience of a longer period, we look at the record of the past 5 years, and finally we appraise the outlook for 1963.

COMPARISON OF 1962 WITH 1961

Significant gains were registered in all major categories of economic activity between 1961 and 1962. For the year 1962 as a whole, gross national product (GNP) rose 7 percent over its 1961 level—from $519 billion to $554 billion. Industrial production showed an 8 percent rise. Demands for automobiles and housing were particularly strong: sales of domestic automobiles increased by more than 20 percent—from 5.6 million units in 1961 to 6.8 million units in 1962—making 1962 the second biggest automobile year in history; private nonfarm housing starts rose by 11 percent, with an exceptionally strong advance in apartment construction. Business spending on plant and equipment rose by 9 percent, and the rate of business inventory accumulation increased from $2.1 billion to $3.1 billion.

Disposable personal income increased by $19 billion, or 5 percent. Consumer spending kept pace and, apart from autos, most major components of consumption rose by 4 or 5 percent. Corporate profits (adjusted for inventory valuation, and before taxes) for the year rose by an estimated $5½ billion, to $51 billion.

The gains in output and incomes achieved in 1962 were accompanied by relative stability in prices. The average price of output increased by less than 1½ percent as measured by the comprehensive GNP deflator. Wholesale prices remained virtually stable at 100.6 percent of their 1957–59 average. And consumer prices rose by only 1.2 percent.

The unemployment rate, which averaged 6.7 percent in 1961, fell to an average of 5.6 percent in 1962—the result of an increase of 1.2 million in employment accompanied by an increase of 400,000 in the civilian labor force. The number of involuntary part-time workers declined from 2.8 million to 2.3 million. The fraction of labor-force time lost through unemployment and part-time work dropped from 8.0 to 6.7 percent. The higher levels of employment resulted in a substantial reduction in the number of depressed areas. During 1961, an average of 81 of the 150 major labor market areas in the United States were classified as areas of substantial unemployment. The monthly average for 1962 was 52 areas. Some areas benefited dramatically from the expansion in economic activity: for instance, in Detroit, Michigan, the unemployment rate fell from 10.9 percent in 1961 to 6.8 percent in 1962. Even an area like Wheeling, West Virginia, which still had an intolerable unemployment rate in 1962 (12.2 percent), showed improvement from its 15.2 percent rate of the year before.

Progress was also made by the Nation's agricultural population. Farm income per capita from all sources rose from $1,373 in 1961 to $1,430 in 1962. This is nearly 60 percent of the nonfarm per capita income of $2,445. By comparison, per capita income of the farm population averaged approximately 50 percent of per capita income in the nonfarm sector during the mid-1950's and less than 40 percent just prior to World War II.

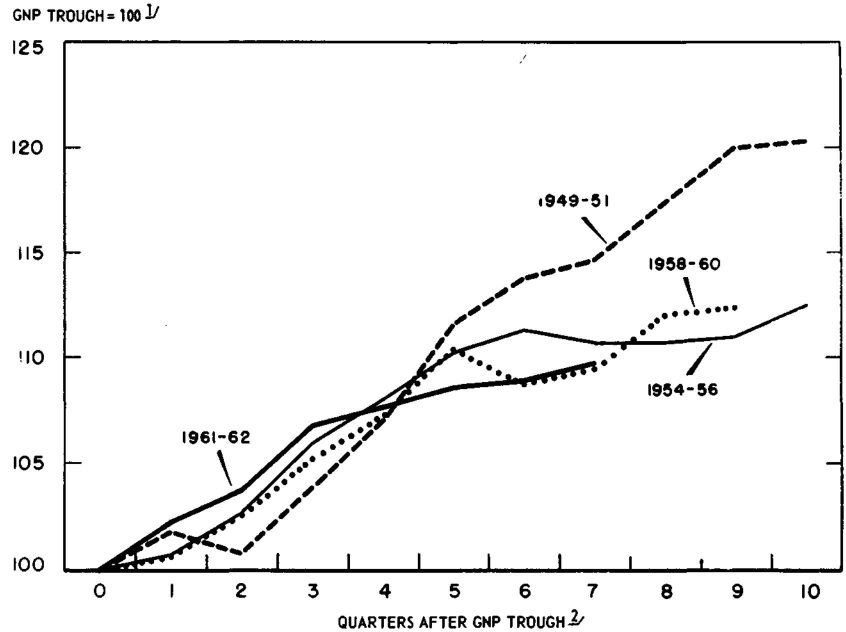
Recovery in domestic output, incomes, and employment was accompanied by improvement in the balance of payments. The over-all balance of payments deficit, which fell from $3.9 billion in 1960 to $2.5 billion in 1961, declined further, to about $2 billion, in 1962. Although exports did not increase as rapidly as the rise in merchandise imports induced by domestic expansion, improvement in the over-all balance was registered because of increased earnings on U.S. investment abroad, and substantial declines in short-term private capital outflows and net government expenditures overseas.

THE RECORD OF THE EXPANSION

The pattern of activity since the 1960 recession is not adequately revealed by the annual figures just cited. The last quarter of 1962 was the seventh quarter of the present expansion and December the 22nd month of sustained recovery from the low point of February 1961. GNP rose to an annual rate of $562 billion in the last quarter of 1962, $61 billion, or

CHART 1

Real Gross National Product in Four Postwar Expansions

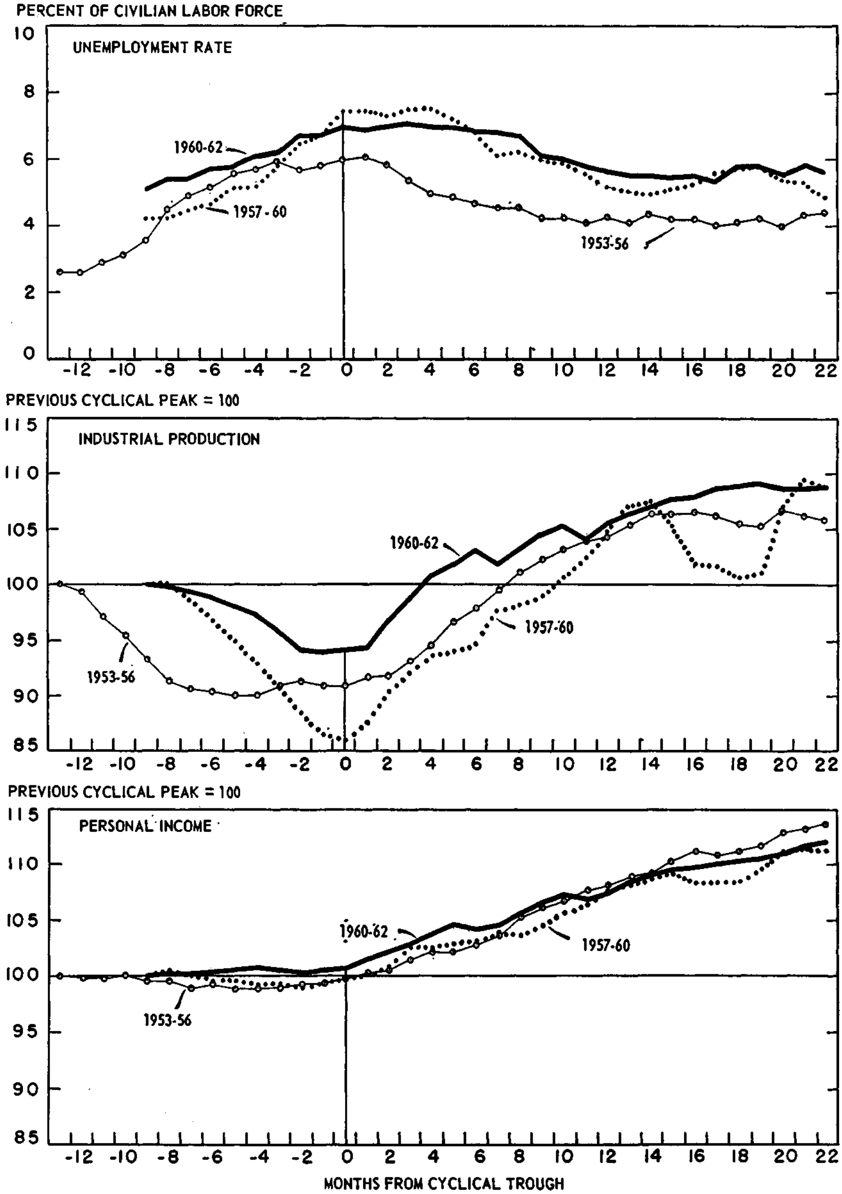


1/ BASED ON SEASONALLY ADJUSTED DATA.
2/ TROUGH QUARTERS FOR GNP WERE 1949 II, 1954 II, 1958 I, AND 1961 I.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

CHART 2

Unemployment, Production, and Income in Three Business Cycles



NOTE: RATE AND INDEXES BASED ON SEASONALLY ADJUSTED DATA. EACH SERIES STARTS AT ITS PREVIOUS CYCLICAL PEAK AND ENDS 22 MONTHS AFTER THE CYCLICAL TROUGH, WHICH CORRESPONDS WITH THE MOST RECENT MONTH OF THE PRESENT EXPANSION.

SOURCES: DEPARTMENT OF LABOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, AND DEPARTMENT OF COMMERCE.

12 percent, above its recession low. In constant prices, this rate was 10 percent above the recession low and 8 percent above the previous peak in the second quarter of 1960.

Despite these gains, the present expansion, along with its immediate predecessor, has not matched the increases in GNP attained at the comparable periods of the two earlier postwar recoveries in 1949–51 and 1954–56, as shown in Chart 1. Chart 2 compares the last three postwar recessions and recoveries in terms of other measures of activity. The comparisons in this chart start with activity at the previous cyclical peaks, not troughs, and thus reflect the record of each cycle over a variable period spanning recession and the first 22 months of expansion. So viewed, the gains in income and production from May 1960 to date approximately match the average of the previous two cycles. But, as already noted, the May 1960 peak itself represented an incomplete recovery.

Slowdown in expansion

As Chart 1 shows, throughout 1961 the current recovery was relatively brisk. However, during 1962, quarterly GNP increases fell to about half their 1961 pace, from an average annual rate of $12½ billion to $6 billion. The slower pace of the expansion is evident in the performance of other major indicators of economic activity during the last 3 quarters of 1961 as opposed to the 4 quarters of 1962 (Table 1). Reflecting the slowdown, the unemployment rate in December 1962 was only 0.4 percentage points below its level a year earlier.

In retrospect, it is clear that the slowdown which was to mark the entire year began in the first quarter. Despite large inventory building, especially of steel, GNP in that quarter rose by only $6.4 billion, after a rise of $16.3 billion in the fourth quarter of 1961.

The second quarter found total activity still expanding moderately. It was marked by the stock market decline that culminated in the historic price break of May 28. The fall in the market contributed uncertainty to the investment outlook later in the year. But the timing indicates strongly that the market break was not a major causal influence on the economic shape of the year as a whole.

By midyear, the uncertainties posed by mixed signs in current economic developments, accompanied by the break in stock prices, led to widespread concern about the possibility of an imminent recession. However, the economy weathered the developments of the spring without a downturn in activity. Stock prices recovered half of their losses by the end of 1962. And business spending on plant and equipment was stronger in the second half than the surveys in February and May had anticipated.

In the third quarter, GNP rose by only $3.3 billion, to $555.3 billion, as net exports declined by $1.2 billion and the rate of inventory accumulation,

TABLE 1.—*Changes in output, income, and employment in 1961 and 1962*

[Seasonally adjusted]

Item	1961 I	1961 IV	1962 IV [1]	Average quarterly change: 1961 I to 1961 IV	Average quarterly change: 1961 IV to 1962 IV [1]
	Billions of dollars, annual rates				
Output (current prices):					
Gross national product	500.8	538.6	562.0	12.6	5.8
Personal consumption expenditures	330.5	346.1	363.5	5.2	4.4
Gross private domestic investment	60.1	76.6	75.0	5.5	-.4
Fixed investment	63.7	70.6	74.5	2.3	1.0
Residential nonfarm construction	19.0	22.8	23.7	1.3	.2
Other construction	20.3	20.4	21.3	(2)	.2
Producers' durable equipment	24.4	27.4	29.6	1.0	.6
Change in business inventories	-3.6	6.0	.5	3.2	-1.4
Net exports of goods and services	5.3	3.8	2.5	-.5	-.3
Government purchases of goods and services	104.8	112.1	121.0	2.4	2.2
Federal	55.4	59.5	63.7	1.4	1.0
State and local	49.4	52.6	57.3	1.1	1.2
Income:					
Disposable personal income	354.3	372.6	389.3	6.1	4.2
Corporate profits after taxes	20.3	26.3	[3] 26.1	2.0	[3] -.1
	Millions of persons				
Employment:					
Total civilian employment	66.8	67.0	68.1	0.1	0.3
Employment in nonagricultural establishments	53.5	54.5	55.6	.3	.3
Private	44.9	45.5	46.2	.2	.2

[1] Preliminary estimates by Council of Economic Advisers.
[2] Less than $50 million.
[3] Data for 1962 III and change from 1961 IV to 1962 III.

NOTE.—Detail will not necessarily add to totals because of rounding.
See Tables C-1, C-15, C-19, C-25, and C-64.

Sources: Department of Commerce and Department of Labor (except as noted).

under pressure from steel liquidation, declined by $3.0 billion from the second quarter level. But by the fourth quarter, exceptionally large early sales of 1963 automobile models helped bring GNP to $562.0 billion.

Role of investment

A year ago the Economic Report and the Budget Message projected a GNP of $570 billion for 1962. After allowance for intervening revisions in the national accounts, this called for a 9 percent rise compared with the 7 percent rise that was achieved. While this was toward the upper end of the range of forecasts then being made, the Administration believed it to be realistic. Now, in restrospect, it can be seen that the predictions of government purchases of goods and services, private nonfarm residential construction, consumer purchases of durables, and net exports were essentially correct.

Consumer purchases of nondurables and services in 1962 fell short of the year-ago forecast by about $6 billion. Changes in such expenditures are largely responsive to changes in disposable personal income which in turn are related to changes in total spending. The percentage of disposable incomes spent by consumers actually rose in 1962. It was therefore the failure of expenditures other than consumption to rise as far as had been expected that held down the rise in incomes and in turn consumers' expenditures.

The error, then, was in the area of business investment, which fell about $8 billion short of the level that had been expected for the year 1962. Indeed from the fourth quarter of 1961 to the fourth quarter of 1962, total business investment actually declined. Expenditures for new plant and equipment rose by $3.1 billion, but this advance was more than offset by a drop of $5.5 billion in the rate of inventory investment. As Chart 3 shows, this decline of investment, which was unuusal for the current stage of expansion, followed 3 quarters of brisk increases in investment spending during 1961.

Half of the shortfall from the prediction of business investment occurred in inventory accumulation. During the current expansion, the ratio of inventory accumulation to the increase in final sales of goods (Table 2) has been only 0.25, compared with ratios of 0.46 and 0.50 in the two preceding expansions. However, the growth of manufacturers' new orders has been slow enough so that unfilled order backlogs have declined and the ratio of inventories to order backlogs has edged upward.

TABLE 2.—*Changes in final sales of goods and inventory accumulation in three expansions*

[Billions of dollars, 1954 prices, seasonally adjusted]

Period [1]	Change in final sales of goods [2]	Inventory accumulation [3]
1954 III to 1956 II	19.1	8.8
1958 II to 1960 I	17.4	8.7
1961 I to 1962 IV [4]	22.1	5.5

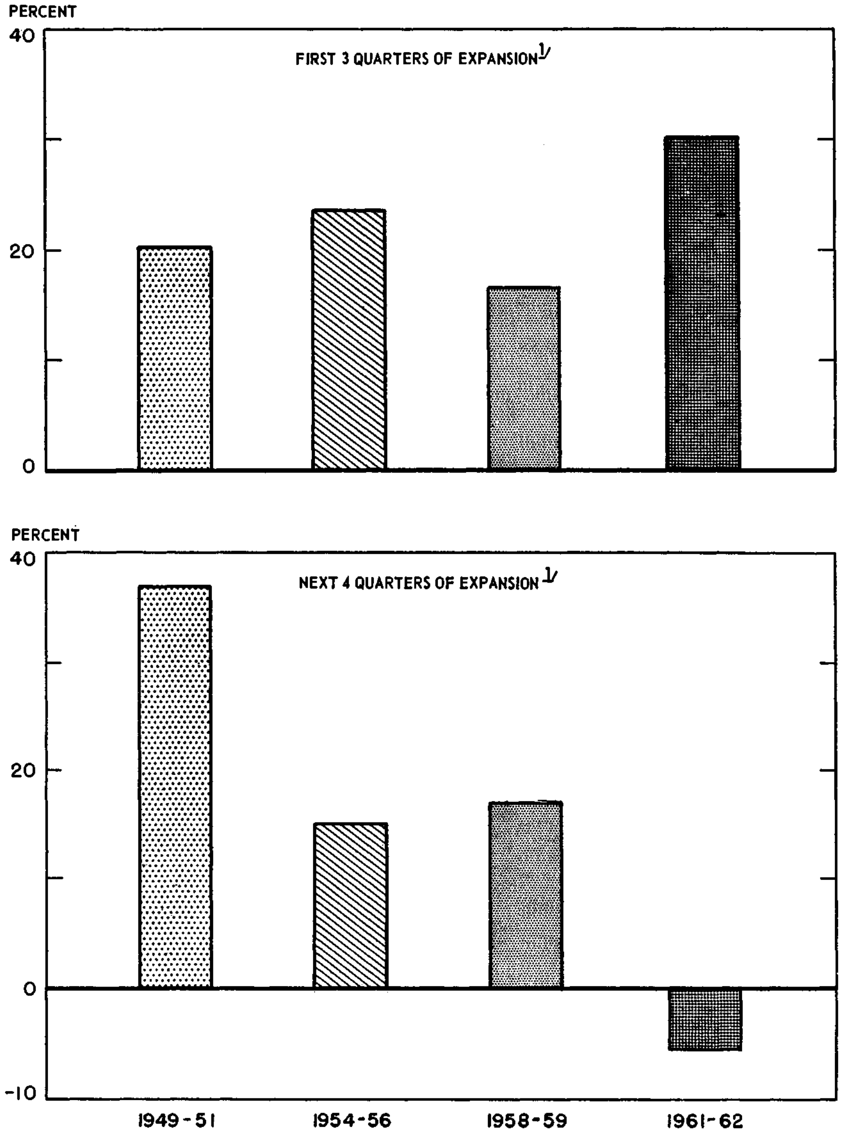
[1] Specific trough for final sales to 7 quarters after trough.
[2] Total change in annual rate of sales.
[3] Total accumulation during period.
[4] Preliminary estimates by Council of Economic Advisers.

Source: Department of Commerce (except as noted).

With easy supply conditions and their own markets growing less than buoyantly, many businesses evidently chose in 1962 to pursue cautious stocking policies and to speed their introduction of new inventory-conserving managerial techniques. Despite the unfavorable effect upon 1962 output and income, inventories, as a result, are less an area of potential weakness in 1963 than might otherwise have been the case.

CHART 3

Change in Total Business Investment in Four Postwar Expansions



1/ BASED ON SEASONALLY ADJUSTED DATA IN CONSTANT PRICES. INVESTMENT CONSISTS OF NONRESIDENTIAL CONSTRUCTION, PRODUCERS' DURABLE EQUIPMENT, AND CHANGE IN INVENTORIES. RECOVERY MEASURED FROM TROUGH QUARTERS FOR GNP: 1949 II, 1954 II, 1958 I, AND 1961 I.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

The other half of the shortfall in 1962 business investment below year-ago expectations was in fixed investment. Although this did rise by 9 percent, 1962 over 1961, it did not exhibit the stronger surge that had been anticipated. A number of conditions that had been expected to facilitate a rapid expansion in plant and equipment spending did in fact materialize. External finance was comparatively cheap and plentiful. Internal finance was relatively abundant; indeed, by the end of the year gross corporate saving exceeded gross investment expenditures by $3 billion. And by summer, as noted in the section that follows, businesses received the combined impetus of liberalized depreciation schedules and an investment tax credit.

To all appearances, the stimulus to invest in new products and in cost-reducing changes of equipment and process remained strong during the year. And the stimulus arising from the current degree of capacity utilization could reasonably have been expected to be stronger than during the preceding expansion. For the index of capacity utilization compiled at the Federal Reserve Board, which rose from 78 percent in the first quarter of 1961 to 85 percent in the fourth quarter of that year, had consistently remained 3 to 5 percentage points above corresponding quarters in the 1958–59 recovery. A similar difference in utilization rates between the end of 1961 and the end of 1958 has also beeen reported in a survey by a private organization.

Rather than in any of these factors, the restraint upon fixed investment in 1962 lay in another circumstance that became increasingly apparent as the year progressed. This was the cumulative effect upon business expectations of 5 years of persisting slack in the economy. By 1962, this prolonged period of underproduction and underemployment had dampened business' willingness to invest. It left businessmen with a long record of consistently, not merely temporarily, redundant capacity. Excess capacity meant lower average profit margins. Further, it meant that new investment was more likely to be risky and less likely to be profitable.

With respect to both fixed investment and inventory investment, in short, the disappointing 1962 performance was a reflection of inadequate demand—not only of a current inadequacy but of one that had been accumulating for half a decade. By the end of 1962, it was plain that businessmen had become conditioned to appraise future expansion cautiously and were slow to extend their commitments beyond near-term needs. Business investment had taken on a character that was likely—in the absence of strong expansionary forces elsewhere in the economy—to cause the economy to stabilize at less-than-full employment levels more or less indefinitely. Plainly, a decisive upward adjustment in the economy's underlying expan-

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sionary forces was needed, and it is this the President's 1963 tax program is designed to supply.

FISCAL POLICY

As remarked already, the President's budget for the fiscal year 1963 expected continuation of the strong tide of recovery that had marked the last 3 quarters of 1961. Fiscal policy was designed to support but not to spur the economy's expansion. The Administration was resolved to avoid repeating the premature and abrupt swing of 1959 toward restrictive budgetary policy. At that time, the budget on a national accounts basis moved from a deficit of $11 billion (annual rate) in the third quarter of 1958 to a surplus of $8 billion 6 quarters later. Federal outlays rose only $1 billion while revenues rose $20 billion, reflecting improved corporate profits, the continuing growth of personal incomes, and higher tax rates for social insurance. Between the calendar years 1959 and 1960, the estimated budget surplus that would occur at 4 percent unemployment rose from $6 billion to over $13 billion. During 1961, the first year of this Administration, this implicit surplus was reduced to about $8 billion. The budget presented last January envisioned little further change in this surplus.

Actual revenues were expected to increase rapidly as profits and employment improved in 1962, and Federal receipts and expenditures in the administrative budget were expected to be almost exactly balanced in fiscal 1963. The fiscal 1963 Budget Message noted explicitly that a deficit would appropriately occur if the expansion fell below expectations. When this happened, the automatic shortfall in revenues helped to cushion the burden of taxes on private demand.

Two important changes in taxation were initiated in 1962 to help to stimulate the investment needed for sustained expansion and longer-run growth. On July 11, the Treasury Department issued revised guidelines for determining depreciation schedules for tax purposes. Their effect was to increase, in some cases substantially, the rate at which business firms can write off plant and equipment, thus reducing corporate profits tax liabilities. In addition, the new procedures permit management greater flexibility in determining depreciation charges and allow more fully for prospective obsolescence. As a further encouragement to investment, Congress in October enacted an investment tax credit as part of the Administration-supported Revenue Act of 1962. This credit permits corporations to deduct from their tax liabilities a part of the cost of newly acquired equipment. Taken together, these two changes increase the flow of internal funds by over $2 billion a year and strengthen incentives to invest by an estimated 20 percent increase in the profitability of eligible new investment in plant and equipment. These two measures are described in more detail in Appendix A.

The Public Works Acceleration Act of 1962, passed by the Congress in September, authorized the President to inaugurate public works programs in areas of persistent and substantial unemployment and underemployment. The Administration moved rapidly to carry out this program, which permits acceleration of work on Federal projects, as well as grants for State and local projects. (See Appendix A.)

During the late spring and summer as the slowdown generated concern about impending recession, the Administration considered carefully the need for stronger fiscal measures. By the middle of August, the evidence pointed to continued expansion through 1962. In his August 13 address, the President reviewed the economic situation and discussed his decision to ask the Congress to enact comprehensive tax reduction and reform legislation in 1963 to meet our basic longer-term needs but not to ask for tax reduction in 1962 on an emergency basis.

MONETARY AND DEBT MANAGEMENT POLICIES

Monetary policy has remained favorable to economic expansion. During 1962, most interest rates on long-term financing fell below their levels at the trough of the recession in February 1961 (Chart 4). While this was partly a passive result of economic slack and stability in the price level, it also reflected deliberate effort on the part of the monetary authorities to maintain adequate liquidity and favorable credit conditions.

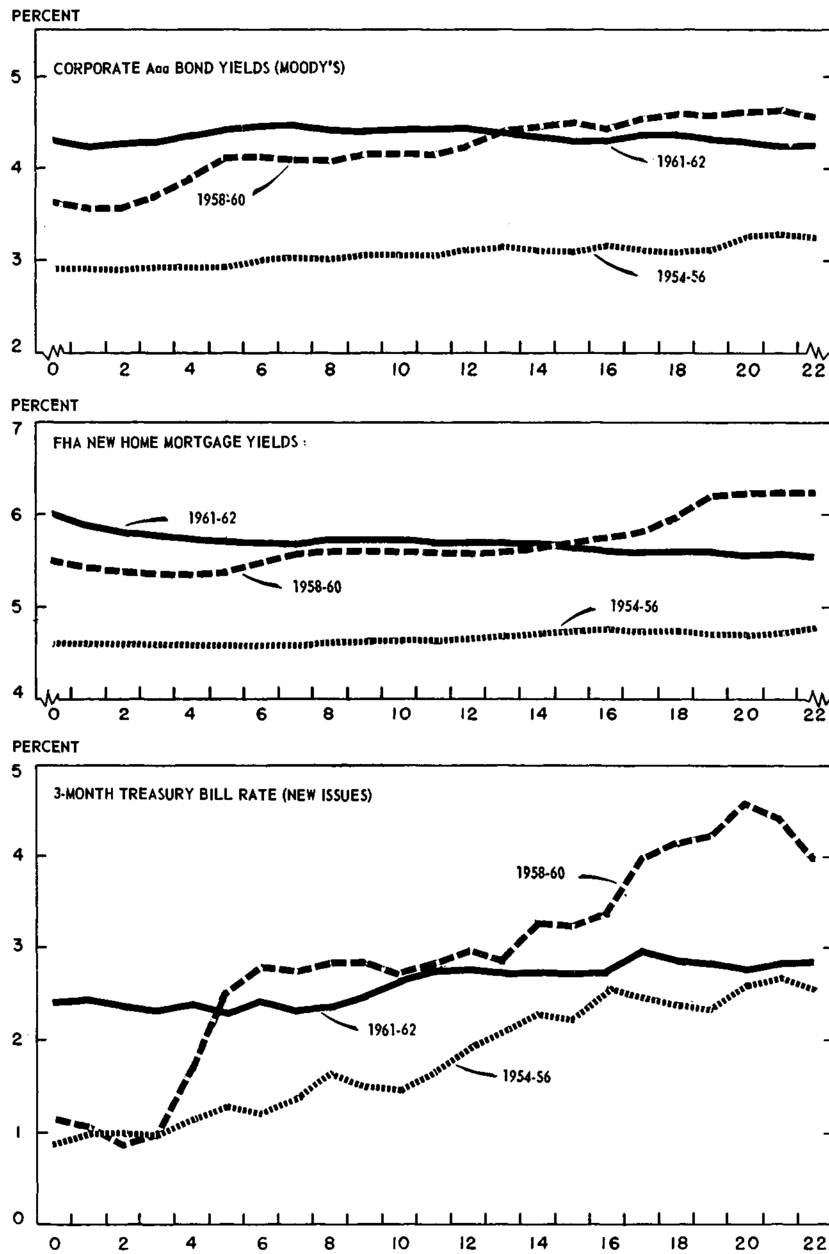
Monetary and debt management authorities faced a continuous challenge in maintaining such credit conditions without encouraging short-term capital movements that would hinder improvement in the U.S. balance of payments. Since mid-1960, monetary and debt management authorities have worked together to keep short-term interest rates from falling out of line with rates abroad.

Federal Reserve open market operations were geared to two objectives. First, they provided the basis for deposit expansion as well as restoring to the banking system reserves absorbed by the decline in the gold stock and the rise in currency in circulation. Since the Federal Reserve also reduced cash reserve requirements against savings and time deposits from 5 to 4 percent, the result was an effective net increase in reserves of more than $1 billion during the year.

Second, purchases and sales of U.S. Government securities were designed to minimize the downward pressures on short-term interest rates resulting from monetary expansion, while encouraging the flow of long-term funds and keeping downward pressures on long-term rates needed for domestic recovery and growth. The Federal Reserve System continued the policy, begun in February 1961, of purchasing longer-term securities, although on a more moderate scale in 1962 than in 1961. Most purchases, on balance, were concentrated in the 1–5 year range. There were negligible net purchases of securities with maturities of under 1 year.

CHART 4

Interest Rates in Three Postwar Expansions



SOURCES: MOODY'S INVESTORS SERVICE, FEDERAL HOUSING ADMINISTRATION (FHA), AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

TABLE 3.—*Net funds raised by nonfinancial borrowers, 1957–62*

[Billions of dollars]

Borrower	1957	1958	1959	1960	1961	1962 [1]
Total	32.5	42.8	52.7	36.2	46.3	58.3
Federal Government [2]	−1.3	8.6	8.7	−2.2	7.4	7.4
Foreign borrowers	1.4	2.3	.8	2.0	2.7	1.5
Private domestic nonfinancial sectors	32.4	31.9	43.1	36.3	36.2	49.4
Loans	6.8	3.1	14.1	11.0	5.8	14.6
Consumer credit	2.6	.1	6.1	4.4	1.4	5.5
Bank loans [3]	2.3	1.8	5.6	2.9	2.3	4.8
Other loans	1.9	1.1	2.4	3.7	2.2	4.3
Securities and mortgages	25.6	28.8	29.1	25.3	30.4	34.8
State and local obligations	4.6	5.5	4.7	3.7	5.1	5.4
Corporate securities	8.8	8.0	5.4	5.4	7.0	5.2
1-to-4 family mortgages	8.6	10.1	13.2	10.4	12.1	15.2
Other mortgages	3.5	5.2	5.8	5.8	6.1	9.0

[1] Preliminary estimates by Council of Economic Advisers.
[2] Includes CCC-guaranteed loans.
[3] Bank loans not elsewhere classified.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: Board of Governors of the Federal Reserve System (except as noted).

Meanwhile, the Treasury expanded its cash offerings of securities of under 1-year maturity. As a result of this and other factors, $1 billion was added to the public's holdings of short-term securities. At the same time, as explained in Chapter 2, the Treasury lengthened the average maturity of the publicly held debt by 5 months, largely through advance refunding operations.

Growth in private demand deposits and currency was $2.3 billion, or only 1½ percent. But the increase in maximum rates payable on commercial bank savings and time deposits under Regulation Q led to a $15 billion rise in these deposits. The money supply—currency and demand deposits—plus savings and time deposits rose by about 7½ percent, somewhat faster than in 1961.

The pattern of commercial bank credit expansion was different from that of 1961 because of three related factors which affected credit: private loan demand grew moderately as economic activity expanded; expectations for stable long-term interest rates formed; and the inflow of savings and time deposits accelerated.

As a result, business lending was the highest in 3 years, and banks were a major factor in the capital markets. Banks added record amounts—over $9 billion—to their holdings both of State and local government securities and of mortgages, but they did not add to their holdings of U.S. Government securities, as they had in 1961. The postwar cyclical pattern of interest rates had led the financial community to expect rising long-term interest rates once recovery began in February 1961. This expectation helped to prevent long-term interest rates from moving downward in the early months of expansion. But as monetary ease persisted, and inflationary psychology waned, this pattern of expectations broke down, and lenders entered longer-term capital markets more aggressively. The abundant flow of funds through institutions that lend in the long-term capital markets, and the substantial operations of commercial banks, helped support a new record volume of mortgage financing, while State and local governmental securities flotations increased somewhat (Table 3).

New issues of corporate securities fell off substantially in the face of modest capital expenditures relative to the large internal cash flow.

THE FIVE-YEAR RECORD

The slowdown of 1962 was rooted in the prolonged sag of demand below capacity that has continued since 1957. The forces that have kept us below full employment in the past several years persist. Our challenge now is to overcome them.

The 1957–62 period matches neither our own record of performance between 1947 and 1957, nor the gains achieved by other free nations (see Chapter 4). The annual growth rates of output, income, and productivity have all run about 1 percentage point lower in the most recent period than in the previous decade, as Table 4 shows.

TABLE 4.—*Changes in output, income, and employment in two postwar periods*

[Percentage change per year]

Item	1947–57	1957–62 [1]
Gross national product (GNP), constant prices	3.9	3.0
Private GNP, constant prices [2]	3.9	3.0
Industrial production	4.4	3.3
Disposable personal income, constant prices	3.9	3.1
Labor force [3]	1.4	1.1
Employment [3]	1.3	.9
GNP per capita, constant prices	2.1	1.2
Private GNP per man-hour, constant prices	3.7	2.7
Disposable personal income per capita, constant prices	2.1	1.3

[1] Based on preliminary estimates for 1962 by Council of Economic Advisers.
[2] Total gross national product less compensation of general government employees.
[3] Includes armed forces; data for 1962 adjusted by Council of Economic Advisers for comparability with data for preceding years.

Sources: Department of Commerce, Board of Governors of the Federal Reserve System, and Department of Labor (except as noted).

In the past 5 years, the economy has been consistently out of balance—with too little demand to match our supply capabilities. In the first postwar decade, when demands were considerably stronger, the balance was frequently tipped in the other direction. There are several reasons why total private demand—and especially investment demand—was particularly strong in the 1947–57 period and less buoyant in the recent period. We began the postwar era with an abundance of liquid assets and a dearth of physical assets—plant and equipment, inventories, housing, and consumer durables. As a result, firms and households were eager spenders for goods in the late 1940's. Then the expansionary fiscal actions required by the Korean conflict helped to underwrite full utilization in the early 1950's. Aided by a tax reduction in 1954, the Nation subsequently adjusted readily to a peacetime, high-defense environment. Demand for capital goods and automobiles sparked a brisk advance toward full employment during 1955. Prices rose considerably in 1956–57, and monetary and fiscal policies were tightened.

When prices stabilized and output began to fall short of full utilization, fiscal and monetary policy continued to treat excess demand as the principal threat to our economic performance. Tax reduction was widely discussed in 1958 but was rejected as unnecessary for reversing recession—a correct judgment in view of the April upturn—and as overly expansionary for the longer run—a judgment that now appears incorrect. In 1959–60 fiscal and monetary policies were tightened sharply in response to what was considered a lingering inflationary threat, contributing to the brief duration and weakness of the 1958–60 expansion. In the immediate postwar years, it took time for policy to be adjusted to the strength of the expansionary forces; later, it again took time to recognize that these forces had largely expended themselves. In the current expansion, no backlogs of private demand, no sums of excess liquidity, no unusual body of deferred technical changes have been present to push the economy toward full employment. And once unemployment of manpower and machines had persisted for nearly 5 years, expectations in 1962 were colored by the suspicion that underutilization was to be the normal state of the American economy. As a result, inadequate demand remains the clear and present danger to an improved economic performance. The manifestations and costs of this imbalance are evident in a review of unemployment and production in the 1957–62 period.

RECORD OF UNEMPLOYMENT

Unemployment has been consistently and significantly higher since 1957 than it was in earlier postwar years. The unemployment rate averaged 4.3 percent of the civilian labor force during the decade which ended in 1957, and exceeded 4 percent significantly only during recessions and early phases of recovery. Since then, unemployment has averaged 6.0 percent and has been below 5 percent for only 1 month in the past 5 years. Both the average number of persons unemployed and the average length of each spell of unemployment have risen. From 1948 to 1957, the average duration of unemployment was 10.3 weeks; since then it has been 14.3 weeks. The comparability of the unemployment data for the years of the postwar era has recently been reaffirmed by the President's Committee to Appraise Employment and Unemployment Statistics.

TABLE 5.—*Unemployment rates for experienced wage and salary workers, by industry, 1957, 1961, and 1962*

[Percent [1]]

Industry	1957	1961	1962
Total experienced wage and salary workers	4.5	6.8	5.5
Nonagricultural industries	4.5	6.7	5.5
Mining, forestry, fisheries	6.3	11.6	8.6
Construction	9.8	14.1	12.0
Manufacturing	5.0	7.7	5.8
Durable goods	4.9	8.4	5.7
Nondurable goods	5.3	6.7	5.9
Transportation and public utilities	3.1	5.1	3.9
Wholesale and retail trade	4.5	7.2	6.3
Finance, insurance, and real estate	1.8	3.3	3.1
Service industries	3.4	4.9	4.3
Public administration	2.0	2.7	2.2

[1] Percent of civilian labor force in each group who were unemployed.

Source: Department of Labor.

As shown in Table 5, unemployment has risen since 1957 among workers attached to services, finance, and trade—industries where employment is at or near record levels—as well as among workers attached to manufacturing, mining, construction, and transportation and public utilities—industries where employment remains below earlier highs. Similarly, as shown in table 6, no major occupational group has been spared higher

TABLE 6.—*Unemployment rates by occupation, 1957, 1961, and 1962*

[Percent [1]]

Occupation	1957 [2]	1961	1962
Total unemployed	4.3	6.7	5.6
Experienced workers	3.9	5.9	4.9
Professional, technical, and kindred workers	1.2	2.0	1.7
Medical and other health workers	1.4	1.4	1.4
Teachers, except college	.7	1.3	1.3
Other professional, technical, and kindred workers	1.3	2.5	2.0
Farmers and farm managers	.3	.4	.3
Managers, officials, and proprietors, except farm	1.0	1.8	1.5
Clerical and kindred workers	2.8	4.6	3.9
Stenographers, typists, and secretaries	2.3	3.7	3.4
Sales workers	2.6	4.7	4.1
Craftsmen, foremen, and kindred workers	3.8	6.3	5.1
Carpenters	8.1	12.3	9.4
Construction craftsmen, except carpenters	6.4	10.7	8.8
Mechanics and repairmen	2.8	4.7	3.6
Metal craftsmen, except mechanics	2.6	6.2	3.4
Other craftsmen and kindred workers	2.4	3.4	3.4
Foremen, not elsewhere classified	1.7	2.6	2.6
Operatives and kindred workers	6.3	9.6	7.5
Private household workers	3.7	5.9	4.9
Service workers, except private household	5.1	7.4	6.4
Farm laborers and foremen	3.7	5.7	4.3
Laborers, except farm and mine	9.4	14.5	12.4

[1] Percent of civilian labor force in each category who were unemployed.
[2] Average of January, April, July, and October estimates.

Source: Department of Labor.

unemployment rates since 1957. The rise has affected professional and technical workers, craftsmen, clerks and sales workers, as well as unskilled and semiskilled workers. Higher unemployment exists even among skill categories in which labor is still assumed to be in short supply. For instance, unemployment rates have risen among mechanics and repairmen, stenographers, clerks and typists, and teachers.

The statistics given above indicate that today jobs are more scarce than skills. But the skills of the labor force must continually adjust to changes in demand and technology, and these adjustments are neither easy nor automatic.

The incidence of high unemployment has fallen most sharply on young persons newly entering the labor market. The inadequate rate of growth in job opportunities has resulted in new entrants encountering special difficulty in finding jobs despite their better educational qualifications. Though lacking in experience and specific skills, young entrants to the labor force are better educated than the average worker and significantly better educated than older workers retiring from the labor market. This has resulted in an increasing proportion of younger persons entering the white collar and more highly skilled occupations, but has not prevented a dramatic rise in the unemployment rate for the group as a whole.

Even during highly prosperous years, there is an imperfect matching of unfilled jobs with unemployed labor. Technological changes, shifting patterns of demand, and the relocation of industry are continuously displacing workers. New skill requirements arise, and old ones become redundant. As a result, there are always unmanned jobs and jobless men. But it is reasonably certain that the number of unfilled job vacancies has not risen along with unemployment these past 5 years. The United States unfortunately does not have a comprehensive statistical series on job vacancies—although work leading to the eventual institution of such a series is being recommended in this year's budget. However, the index of help-wanted advertisements compiled by the National Industrial Conference Board—a partial measure of job vacancies—indicates a substantially smaller volume of such advertisements in 1962 than in 1957 after adjustment is made for growth of the labor force. Higher unemployment is explained by the shortage of new job opportunities; the matching of unfilled jobs and unemployed workers has not become any less efficient in recent years, though current efforts to make it more efficient were long overdue.

The problems of structural unemployment—of imperfect adaptation of jobs and workers—are persistent and serious, and they are thrown into bold relief by the prolonged lack of sufficient job opportunities over the past 5 years. But these problems of adaptation have not constituted a greater cause of unemployment in recent years than in earlier periods. The source of the high unemployment rates in recent years, even in periods of cyclical expansion, lies not in labor market imbalance, but in the markets for goods and services.

While aggregate output rose by 3 percent a year from 1957 to 1962, the productive capacity of the economy rose even faster. A gap between potential and actual output began to emerge in the late stages of the 1954–57 expansion and has persisted ever since. From 1958 through 1962, actual fell short of potential by more than 6 percent on the average.

The difference between unemployment rates of 5.6 percent and 4 percent understates the loss of output that occurred in 1962. Higher employment in a slack economy brings with it higher man-hour productivity through more efficient use of manpower and machinery. In addition, as production moves at a faster pace the total number of hours worked increases faster than employment itself; fully-employed workers find themselves on overtime, and the substantial number of involuntary part-time workers—more than 2 million in 1962—is reduced. Finally, the availability of jobs encourages entry into the labor force of many who had not actively sought work in the knowledge that there was none to be had. The 1962 Report of the Council discussed these aspects of the unemployment-output relationship in more detail.

No precise and unvarying connection exists between higher output and reduced unemployment. The relationship depends on the industry and region producing the added output, the capital available for expanded production, the existing amount of on-the-job underemployment, and the skills of available workers. But our postwar experience indicates that a reduction of 1 percentage point in the global unemployment rate at any moment of time is associated, on the average, with an increase in real GNP of slightly more than 3 percent. Put the other way around, if GNP were 3 percent higher than it is now, the unemployment rate would be approximately 1 percentage point lower.

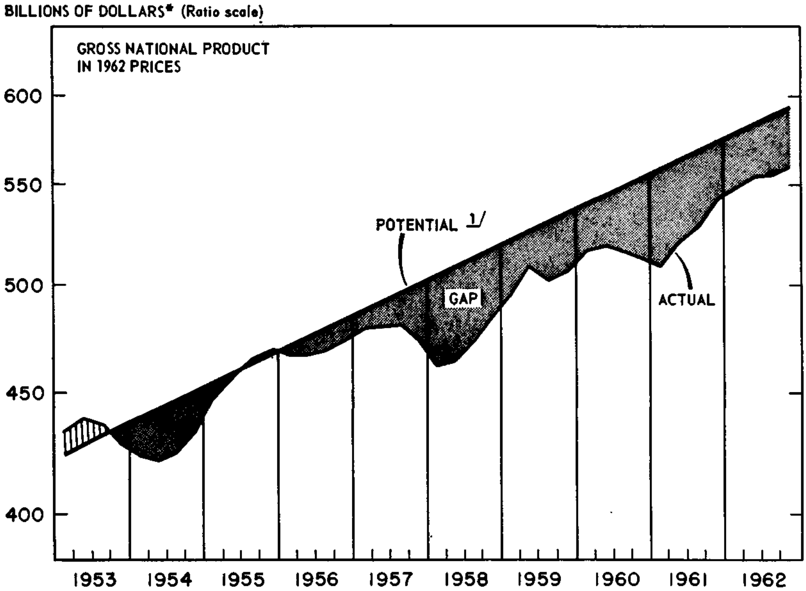
With the passage of time, the unemployment rate will remain constant only if output rises. Because the labor force grows over time, constancy in the unemployment rate means a rise in the number of employed workers and thus requires an increase in total output. And because output per worker also tends to rise—with advances in technology, improvements in skills, and additions of new capital equipment—production must increase faster than employment.

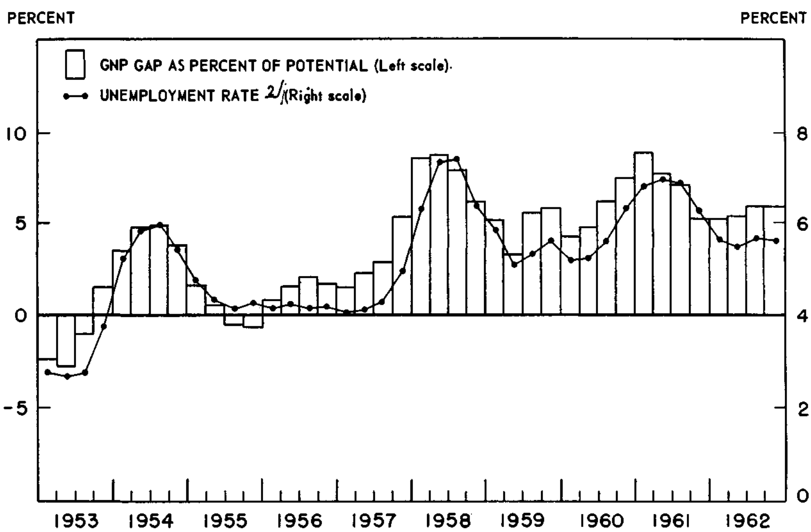
In the post-Korean period, the aggregate output associated with a constant unemployment rate has grown at about 3½ percent a year. For example, in 1954, 1960, and again in 1962, unemployment averaged 5.6 percent of the labor force. From 1954 to 1960, the annual growth rate of output was 3.2 percent; from 1960 to 1962, it was 3.6 percent.

Chart 5 shows the Council's estimate of potential output for the years 1953–62. The path of potential is represented by a 3½ percent trend line through actual output in mid-1955, which is taken as a period of approximately full use of resources. This smooth curve is a consistent approxima-

CHART 5

Gross National Product, Actual and Potential, and Unemployment Rate





* SEASONALLY ADJUSTED ANNUAL RATES.
1/ 3½% TREND LINE THROUGH MIDDLE OF 1955.
2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE; SEASONALLY ADJUSTED.
SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

tion to the more irregular path traced out by the alternative calculation using unemployment rates. (This is suggested by the lower panel of the chart, which compares changes in the gap between actual and potential GNP with fluctuations in the unemployment rate.)

The chart also shows actual GNP and the discrepancy between actual and potential output. The cumulative excess of potential over actual output in the period 1958 to 1962 totals $170 billion (1962 prices) or nearly $1,000 a person. The gap was dramatically reduced during early stages of the two expansions of 1958–59 and 1961. But the subsequent stages of each expansion failed to bring actual GNP up to potential.

The estimate of the gap shown in the chart is consistent also with the evidence on the utilization of industrial capacity. There are statistical difficulties in any attempt to measure capacity and utilization rates, and the available material is relatively narrow in coverage. Nevertheless, it provides a partial check on calculations based primarily on unemployment rates. Since 1957, the average of a quarterly index of manufacturing capacity utilization compiled at the Federal Reserve Board has been 5 percent below the average for 1947–57. In the past 5 years, the index has not exceeded its 1947–57 average. As in all recent years, the 1962 operating rate left room for considerable expansion of output and employment without strain on existing manufacturing capacity.

The thrust of recovery during the past 2 years has narrowed the gap of unrealized potential and excess industrial capacity. The problem remaining is to create an economic environment in which the expansionary powers of the private economy can reinforce each other in a movement toward full utilization. Once we have brought our actual performance up to our potential, we can look toward a more rapid growth of our potential as well. From 1947 to 1955, GNP in constant prices, matching the growth of potential GNP, rose at an average annual rate of 4.3 percent. The lower 3½ percent growth rate of potential in recent years is attributable to our failure to use existing capacity fully, thereby blunting the incentives for investment and innovations.

THE LEVEL AND PATTERN OF DEMAND

Higher rates of unemployment, slower advances in output, excess industrial capacity, reduced growth of incomes—these features of our economy in the past several years are not separate phenomena. They are all part of the syndrome of persistently sluggish demand. Total expenditures for goods and services have been insufficient to take full advantage of our capacity to produce, to keep our manpower and machines fully employed, and to support the rapid growth of incomes of which the economy is capable.

The relative strength or weakness of the major categories of demand has varied during the period. Thus Federal purchases of goods and services in constant (1962) prices declined by $4.6 billion between the end of 1958 and the end of 1960. As a fraction of disposable income, consumption ranged from a low of 92 percent in 1958 to a high of 94 percent in 1960. Expenditures on new housing showed strength in 1958–59 and 1961–62. Business investment in fixed assets and inventories fluctuated cyclically around a relatively low average. However, the variations from component to component and from year to year are less significant than the consistent insufficiency of total expenditures. The weakness of total demand held down capacity utilization and retarded the incentives for investment. Weak investment in turn slowed the growth of incomes and demand.

Investment

Throughout the 1957–62 period, weakness in the demand for investment goods was both cause and effect of the weakness of total demand. Unlike other major components of GNP, gross private domestic investment in 1962 prices has shown no upward trend since the mid-1950's. After a brisk rise of about 50 percent from 1947, it reached a peak of $75 billion in 1955, then fell, and did not return to the 1955 level until 1962, when real GNP was 16 percent larger.

Business fixed investment was high in the early postwar years, averaging about 12 percent of total output (1962 prices) in 1947–48. Demand for plant and equipment was especially strong after nearly 2 decades of low growth in capacity associated with the depression of the 1930's and the war. From 1949 through 1957, business fixed investment remained within a range of 10 to 11 percent of real GNP. In sharp contrast, during the past 5 years the proportion of output devoted to business fixed investment has averaged only 9 percent. This trend is shown in Chart 7 in Chapter 2.

The relative weakness in plant and equipment outlays in recent years is reflected in the apparently slow growth of business fixed capital. The amount of business fixed capital in useful existence can only be inferred. But using average service lives based on actual business practice, the Department of Commerce estimates that the existing stock of business structures and equipment has increased by only 2 percent per year over the past 5 years, compared with 4 percent a year in the period 1947–57 (Table 7).

TABLE 7.—*Growth of gross stocks of fixed business capital in two postwar periods* [1]

[Percentage change per year]

Type of stock	1947–57	1957–62 [2]
Total nonfarm	3.9	1.7
Structures	1.7	2.7
Equipment	6.9	.6
Manufacturing	4.3	1.2
Structures	1.7	.4
Equipment	6.5	1.6

[1] Based on stocks, in 1954 prices, at end of year; lives 20 percent shorter than in Internal Revenue Service Bulletin F (1942 edition).
[2] Based on preliminary estimates for 1962 by Council of Economic Advisers.

Sources: Department of Commerce and Council of Economic Advisers.

Changing incentives to invest are reflected in the relationship between corporate saving and investment. Profitable and expanding markets lead businessmen to invest more than their gross retained earnings. Through their participation in debt and equity markets, business firms then channel personal savings into new capital goods and inventories. Chart 6 shows that, from 1947 to 1957, nonfinancial corporations generally invested more than their own gross saving. The only exceptions in that period occurred in the recession years of 1949 and 1954. But, since 1957, the relationship has been reversed: investment by corporations in plant, equipment and additions to inventories has not kept pace with gross retained earnings. Corporate investment fell considerably short of corporate saving in 1958 and 1961, and exceeded saving by a bare margin in 1959 and 1960. The past year, 1962, was the first in the postwar era when corporate investment fell short of corporate saving in a year untinged by recession. While the slow pace of advance in the economy since 1957 has held down the supply of internal funds to nonfinancial corporations, their incentives to invest have not even kept pace with the over-all availability of internal funds.

Residential construction expenditures are so volatile from year to year that a clear trend is hard to discern. The record does suggest that the rise in construction activity slowed after the first postwar decade. Housing activity in 1961–62 surpassed the 1955–57 average by less than 15 percent, while construction in 1955–57 represented a 55 percent gain over 1947–49. Expenditures on residential construction remained the same percentage of personal disposable income (in 1962 prices), 6.0 percent, during 1958–62 as in the previous decade. In view of the large backlog of housing demand in the earlier period, housing activity has held up well.

Consumption

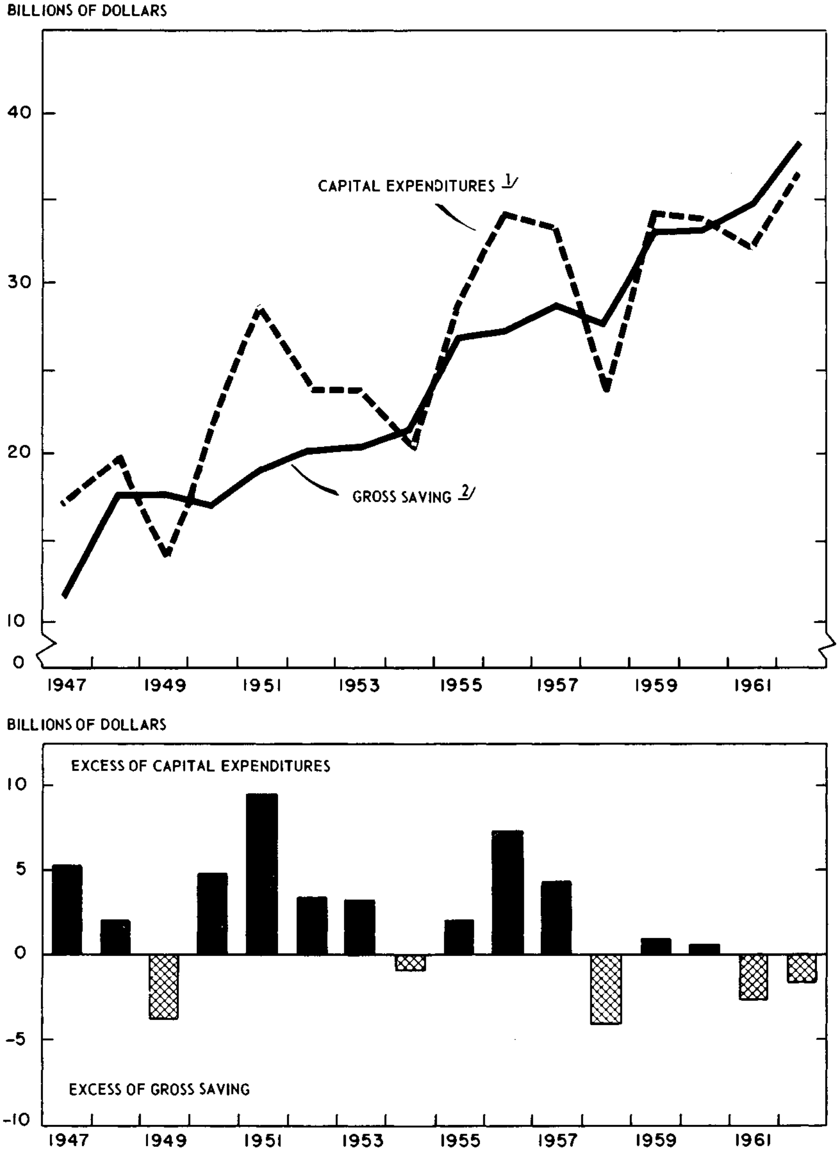
In 1947–49, consumer outlays clearly exerted an important expansionary force on the economy, averaging more than 95 percent of disposable income over the 3-year interval. Since 1950, however, the fraction of disposable personal income spent on consumers goods and services has remained between 92 and 94 percent each year. The fraction has varied in this range from year to year, but it has shown no clear trend. Consumers expenditures have not been constrained in recent years by any unwillingness of consumers to spend out of their disposable incomes.

But the growth of consumption has slowed, constrained both by a smaller rise in personal income and by the high and increasing bite of personal taxes. As a result of a rising ratio of personal tax collections—both Federal and State and local—to personal income, disposable personal income as a fraction of personal income has declined from 87.9 percent in 1957 to 86.9 percent in 1962.

Since 1951, the proportion of disposable income (1962 prices) spent on durable goods has shown no trend, although it ranged from a high of 13.6 percent in 1955 to a low of 11.3 percent in 1958. It averaged 12.1

CHART 6

Gross Saving and Capital Expenditures of Corporate Nonfinancial Business



1/ CONSTRUCTION, EQUIPMENT, AND CHANGE IN INVENTORIES.
2/ PROFITS AFTER TAX ACCRUALS AND DIVIDENDS PLUS CAPITAL CONSUMPTION ALLOWANCES.
SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND COUNCIL OF ECONOMIC ADVISERS.

percent from 1958 to 1962. This stable proportion gives strong evidence of the continuing demand for durables. Automobile sales have been supported by increasing replacement demand and the growing tendency of families to own more than one car. Expenditures on other durables have grown proportionally with incomes. Since 1957, an increased—but still small—fraction of households have acquired such items as air conditioners, dishwashers, dryers, and freezers.

The most notable change in the composition of consumption in the postwar period has been the shift away from nondurable goods and toward services. From 1951 to 1962, the proportion of disposable income (1962 prices) spent on nondurables fell from 45.8 to 42.3 percent, while the fraction spent on services rose from 34.9 to 38.5 percent.

Conclusion

Total demand depends on the strength of expenditures in the several sectors of the economy. But it is not a simple sum of the parts. Exceptional strength in any component of expenditure will raise employment and capacity utilization, household incomes and business profits, consumption and investment, spreading its expansionary influence throughout the economy. These forces can sometimes be too strong, and they then need to be restrained by fiscal and monetary policies.

At other times, there may be no exceptional upward drive in the economy. In this type of situation, weakness in any sector is diffused throughout the economy unless it is offset by a sufficiently expansionary fiscal or monetary policy. In the past 5 years, total demands have not been adequate to promote rapid growth of incomes. Consumption has not generated the profitable markets needed to stimulate investment; and investment spending has not generated the incomes needed to promote strong gains in consumption. Even though the capital stock has grown slowly, so has total demand; thus the economy has not been able to grow into its unused capacity. And as sluggishness has persisted, unfavorable experiences have generated unfavorable expectations and cautious planning, reinforcing the inadequacy of demand.

Taking the past 2 years by themselves, gains in employment, incomes, and output have been substantial. Fiscal and monetary policies have supported recovery from the recession. However, despite this encouraging progress it is now apparent that demands originating in the private economy are insufficient by themselves to carry us to full employment. Nowhere are there visible spontaneous forces of sufficient strength to put an end to the period of slow growth. But there is a way: through tax reductions and reforms, the Federal Government can relax its restraints on the expansionary power of the private economy.

The Employment Act of 1946 requires estimates of "current and foreseeable trends in the levels of employment, production, and purchasing power." This is a wise and constructive mandate. The plans and policies of both Government and business are forward-looking: they influence the future; they must rest—however uneasily—on expectations about the future.

For some purposes, the forecasts upon which public policies are based need not be numerically precise. As a justification for an expansionary tax reduction in 1963, for example, it is enough to know that, lacking such a cut, the prospect for 1963 and beyond is for substantial shortfalls of demand below capacity. On the other hand, the need, for budgetary purposes, to make fairly exact projections of Federal revenues requires the relatively precise kind of forecast—namely, that GNP will amount to $578 billion, plus or minus $5 billion—contained in this year's Budget Message. This estimate implies moderate gains in employment, production, and purchasing power throughout 1963, with expansion beginning to accelerate later in the year in response to the President's tax program. The average quarterly gain in GNP during the course of the year would be about the same as in 1962—nearly $6 billion.

The projection for 1963 emerges from a survey of prospects for the major categories of public and private spending.

GOVERNMENT PURCHASES OF GOODS AND SERVICES

The budget estimates for the fiscal years 1963 and 1964 indicate that Federal purchases, reflecting increases in defense and space activities, should continue to rise, reaching in the calendar year 1963 an average $4 billion higher than in calendar 1962. State and local purchases are expected to continue rising at the same pace as in recent years, adding another $4 billion increase in total spending.

RESIDENTIAL CONSTRUCTION

Although down a bit from the preceding quarter, activity in housing remained strong at the year-end; November starts and permits were above the 1962 average. Basic demand, supply, and financial conditions should be as favorable in 1963 as they were in 1962. In the past, housing has usually declined considerably before a downturn in over-all activity, at least partly in response to monetary tightness. Ease in mortgage markets is expected to continue in 1963, reinforcing the prospects for sustained strength in residential construction. The best estimate is that nonfarm housing starts and residential construction expenditures will hold at about their 1962 levels.

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BUSINESS FIXED INVESTMENT

Business investment in plant and equipment during 1963 is expected to show modest gains above 1962 levels. Its progress is estimated in the light of the following factors:

1. Over-all rates of capacity utilization improved markedly in 1961, but they leveled off well short of full utilization during 1962. There is little prospect of an improvement in operating rates in the near future.
2. The ready availability of funds will continue to favor investment in 1963. In both 1961 and 1962, gross corporate saving exceeded corporate investment. Recent tax adjustments are adding further to business liquidity. And the improved state of equity markets and the continued ease of bond markets will facilitate external financing.
3. New orders for machinery and equipment improved moderately in the second half of 1962. As the year ended, new orders continued to point upward.
4. The November Commerce-SEC survey of investment plans for the first quarter of 1963 gave puzzling results. Estimated expenditures for the last half of 1962 were revised upward by businessmen; yet their plans pointed to a decline in outlays in the first quarter of 1963. Typically, upward revisions of plans are accompanied by continued gains in succeeding quarters, not the reverse. Privately conducted surveys for the year 1963 as a whole report investment plans exceeding 1962 levels by a small margin.
5. Evidence is accumulating that the new depreciation guidelines and the investment tax credit will have a significant influence on investment decisions. According to industry sources, the planned investment of the steel industry has been substantially increased under the stimulus of these measures, and now shows a marked rise over 1962.

Taken together, these considerations support the estimate of a small year-to-year increase in capital outlays.

CHANGE IN BUSINESS INVENTORIES

Businessmen are likely to add to their stocks in 1963, largely in response to moderate increases in final sales of goods. But the expected growth of sales is unlikely to push rates of inventory accumulation above the $3 billion average for 1962. Inventory-sales ratios have, on the whole, remained at conservative levels. The stability of these ratios suggests that businessmen view their current stock-sales relationships as appropriate and are not likely to alter them significantly in either direction in the months ahead. But any sharp departure from expected patterns of final sales would be magnified in this highly volatile component of GNP.

PERSONAL CONSUMPTION EXPENDITURES

Consumer outlays are expected to continue to absorb about 93 percent of disposable personal income in 1963. Services are likely to claim a slightly increased fraction of incomes, with the share devoted to goods declining a bit. Early sales of 1963-model automobiles point to another good year for car sales, but increases in the sales rate achieved in the last quarter of 1962 are unlikely.

Disposable income is expected to grow at a slightly faster rate than GNP in 1963. While the increase in payroll taxes effective January 1, 1963, will retard the rise in disposable income, the prospects for consumer purchasing power are much improved by the President's recommendation for a midyear drop in the withholding rate for individual income taxes.

SUMMARY

In pointing to the likelihood of continued expansion, this review of the major sectors of demand is gratifying; in pointing to continued underutilization, it is challenging.

Continued expansion in 1963 would reverse the apparent postwar trend toward shorter expansions and more frequent recessions. By March 1963, the current expansion will have matched the 1958–60 upswing in duration. If it continues throughout 1963, the present recovery will have lasted 34 months, nearly equaling the 35-month duration of the 1954–57 expansion. The likelihood of such sustained expansion will be increased by prompt enactment of the President's recommendation for tax reduction in 1963.

The estimated GNP for 1963 is 4½ percent above the level of 1962 in current prices. With an increase of this magnitude, real GNP would not change significantly relative to the economy's potential. Neither the average unemployment rate nor excess industrial capacity in 1963 could be expected to decline appreciably. Apart from the effects of reduced taxes, real disposable income per capita and corporate profits could grow slowly at best. The prospects for 1963 reflect the same insufficiency of demand that has slowed our growth in the past several years. New investment will still be inhibited by underutilization of existing capital. Consumer spending will still be held down—until the tax reductions take effect—by a burdensome tax system. With that drain of purchasing power, the achievement of full employment would require a level of private investment that experience suggests will not be forthcoming.

Thus, the prospects for the future join with the facts of the present and the record of the past 5 years in posing a challenge for economic policy. But the same record—past, present, and prospective—furnishes valuable guidance on how to respond to the challenge. It suggests that investment will be brisk when consumer spending provides the stimulus of profitable markets; that consumers' living standards can advance rapidly when business firms have strong incentives to expand employment; that capacity will grow rapidly when existing capacity is put to full and productive use; that a business firm can gear its plans to sustained prosperity when it enjoys buoyant markets; that there is latent strength of private demand which can be activated when tax reduction relaxes the restraints of fiscal policy. The President's proposals for tax legislation in 1963 are fashioned to respond to the realities of the economic record. They are designed to write a far brighter record in the years ahead. As the proposed tax changes take effect and release the force of stronger private demands, we can expect our gains to accelerate markedly. The moderate advance projected for 1963 should be the forerunner of sharply faster advances thereafter. Under the stimulus of tax reduction and reform, the years ahead promise to write a new chapter of full prosperity and rapid growth in our economic history.