Chapter 1

Sustaining Prosperity: Record and Prospects

THE U.S. ECONOMY recorded further progress in 1967. Despite a pronounced inventory adjustment in the first half of the year, expansion continued through an unprecedented seventh consecutive year. The unemployment rate remained at its lowest level in more than a decade—averaging 3.8 percent for the second straight year. The value of the Nation's total output of goods and services—gross national product (GNP)—rose $42 billion to a level now estimated at $785 billion; after allowance for price changes, GNP grew by 2½ percent.

Expansionary fiscal and monetary policies worked to sustain expansion when private demand was sluggish in the first half of 1967. The rebound of the second half reflected the contribution of these forces. As 1968 opens, fiscal policy remains highly stimulative, and it is now overly expansionary in an economy again growing at a rapid pace. The ready availability of credit for housing and other high-priority needs is in jeopardy today, after a rapid rise of interest rates in the second half of 1967.

To avoid a return to severe credit stringency, to promote price stability, and to safeguard the balance of payments, the President is asking Congress to make enactment of a tax surcharge the first order of business in 1968. The outlook for 1968 and its dependence on tax action is set forth in this Chapter. A more detailed discussion of fiscal and monetary policy—past, present, and future—is the subject of Chapter 2.

The unsatisfactory price performance of 1966 continued through 1967; consumer prices again rose nearly 3 percent. The task of decelerating price and cost increases and of gradually restoring price stability, while maintaining high employment, is a key assignment for economic policy in 1968, as Chapter 3 makes clear. Poverty in our cities has received increasing attention. Chapter 4 discusses this and other pressing problems involved in assuring the opportunities of all Americans to obtain adequate health care, housing, and education. The balance of payments was a serious problem in 1967, especially in the closing months. The President has set forth a comprehensive new program to deal decisively with our payments deficit. The key international aspects of our economy are discussed in Chapter 5.

ECONOMIC ACTIVITY IN 1967

Employment expanded in 1967 and the real incomes of American families continued to grow. The purchasing power of the average American—personal disposable income per capita, corrected for price changes—rose 3.2 percent, less than the 3.9 percent annual rate of the 1961–66 period, although well above the 2.3 percent average yearly advance for the entire postwar period.

INCOME AND EMPLOYMENT

Most of the income gains of households came from increased employment and higher wage rates. Incomes from social insurance benefits were also an important contributor; they rose $5 billion, partly reflecting new and expanded programs of health insurance. Dividends, interest, and rental incomes advanced moderately. The income of farm proprietors, however, declined $1¼ billion from its record level of 1966.

The civilian labor force registered an unusually large gain of nearly 1.6 million from 1966 to 1967, and the growth of civilian jobs kept pace. The number of workers on nonfarm payrolls increased by 2.1 million. Manufacturing employment rose only 150,000, the smallest advance since 1963. But private nonfarm employment outside manufacturing increased about as rapidly as in 1965 and 1966, with a gain of 1.2 million. Government employment—predominantly State and local—advanced 750,000. The Armed Forces expanded by an additional 325,000. Total compensation of employees increased $34 billion or 8 percent, reflecting the combination of higher employment and increased wages and fringe benefits.

Corporate profits fared less well in 1967. For the year as a whole, profits before tax are now estimated at $80 billion, down nearly $4 billion from 1966 although well above any previous year. The dip in profits interrupted a sustained six-year advance, which had provided a sharp contrast with the 1950's, when profits did not increase significantly in any two consecutive years. Profits typically decline in a period of slow expansion partly because lagging productivity growth tends to raise unit labor costs. In early 1967 the erosion of profits was accentuated as sluggish output and sales followed a period of particularly rapid growth of capacity and other overhead elements.

PRODUCTION

The growth of output in 1967 was not impressive by the standards of recent years. The 2½-percent increase in real GNP—total output, after adjustment for price changes—was the smallest since 1961, and far short of the 5½-percent yearly average of 1961–66.

Growth rates differed widely among sectors. Industrial production rose only 1 percent from 1966 to 1967, as manufacturing industries bore the brunt of the inventory adjustment and capital goods slowdown. Durable goods output was particularly affected. In the breakdown of real GNP by major product classes, durable goods output rose less than one-half of 1 percent for the year as a whole, while output of nondurable goods rose 3½ percent. The real volume of new structures actually declined from 1966 to 1967. Services registered the largest yearly gain, an advance of 4½ percent in real terms.

PATTERN WITHIN THE YEAR

The annual record for 1967 does not tell the whole story, for there was a marked change of pace between the first and second halves of the year.

Inventory Adjustment in the First Half

The performance of the economy during the first half of 1967 was dominated by a massive adjustment in the rate of inventory accumulation. In many respects, the first half of 1967 resembled other periods of inventory adjustment. But this time the marked reduction in inventory investment did not cumulate into a decline in over-all economic activity.

An inventory adjustment is generated by excessive growth of stocks in relation to sales. In a smoothly expanding economy, production and sales tend to move approximately in parallel, with production exceeding final sales by about 1 percent. This margin allows for the larger inventories of goods at all stages in the pipeline—raw materials, work-in-process, and finished products—that are needed as production and sales advance. When producers are optimistic about sales, they tend to step up their production. If actual demands fail to live up to expectations, sales fall below production by an abnormally wide margin, and inventories pile up.

Such a pattern evolved in 1966. Early in that year, demand was advancing at an unusually rapid pace, led by major increases in defense outlays, an investment boom, and rising consumer expenditures. Business expectations were buoyed up by the vigor of demand. Production expanded steadily. But as the year developed, the optimistic expectations of producers were not completely fulfilled. Final sales slowed down, in part because of monetary and fiscal policy actions designed to moderate the pace of advance. Residential construction fell sharply during the course of 1966, reflecting an extreme shortage of mortgage credit. In the closing months of the year, the end of the plant and equipment boom and a sudden rise in consumer saving weakened over-all demand.

As production continued to increase, the rate of inventory accumulation soared. In the fourth quarter of 1966, inventory investment reached a record $18.5 billion (annual rate). The absolute level of stocks was not greatly excessive in relation to final sales, but the rate of inventory investment had to be decreased sharply to limit further accumulation.

A sharp reduction in the rate of inventory investment tends to weaken final sales as well. When firms cut back production to curb the growth of inventories, the workweek is shortened and some workers are laid off. The cutback of employment lowers household incomes, thereby dampening consumer buying. Meanwhile, declining operating rates in industry weaken incentives for business fixed investment. The process tends to feed on itself. As a result of the initial effort to bring production into line with sales, final demands slow further, and inventories must be curtailed even more to restore balance between stocks and sales.

Inventory adjustment was a basic feature of the four postwar recessions: 1948–49, 1953–54, 1957–58, 1960–61. In each of those periods, real GNP fell between 1½ and 4 percent over a period of two to four quarters, and the unemployment rate rose to 6 percent or more. But the inventory adjustment of 1967 did not lead to a recession. Real GNP was virtually unchanged from the fourth quarter of 1966 to the first quarter of 1967 and then resumed its advance. The unemployment rate remained in a narrow range close to 4 percent throughout the slowdown.

From the fourth quarter of 1966 to the second quarter of 1967, inventory investment fell $18 billion to a near-zero rate. In absolute size (although not as a percentage of total output), this was the largest drop ever over a two-quarter period. Nevertheless, GNP continued to advance, although the pace slowed markedly, as seen in Table 1.

TABLE 1.—*Changes in gross national product and Federal sector of the national income and product accounts since second quarter 1966*

[Billions of dollars, seasonally adjusted annual rates]

Item	Change		
	1966 II to 1966 IV	1966 IV to 1967 II	1967 II to 1967 IV[1]
Gross national product	25.4	13.0	32.5
Change in business inventories	4.5	−18.0	8.5
Final sales	21.0	31.0	24.1
Personal consumption expenditures	12.2	15.9	11.7
Business fixed investment	4.1	−1.3	2.3
Residential structures	−4.9	2.2	4.8
Net exports	−1.1	1.0	−1.3
Government purchases of goods and services:			
Federal	6.6	8.0	2.5
State and local	4.0	5.2	4.1
Federal sector, national income and product accounts:			
Receipts	7.0	−.5	8.1
Expenditures	13.5	10.9	4.7
Defense purchases	7.2	6.9	1.8
Other purchases	−.7	1.1	.7
Other expenditures	6.9	2.9	2.2
Surplus or deficit (−)	−6.5	−11.4	3.4

[1] Preliminary.

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

Sources: Department of Commerce and Council of Economic Advisers.

An unusually large increase in final sales provided the thrust for continued expansion. As shown in Chart 1, the $31 billion advance in final sales over the two quarters represented a marked acceleration from the pace of the preceding three quarters. In fact, the gains in final sales in each of the first two quarters of 1967 had been exceeded only in the booming fourth quarter of 1965 and the first quarter of 1966.

This acceleration in final sales was due mainly to the stimulus provided by rising Federal expenditures and expansionary monetary policy. As recorded in Table 1, Federal defense purchases (annual rate) rose $6.9 billion between the fourth quarter of 1966 and the second quarter of 1967. Meanwhile, Federal transfer payments to persons—principally for increased social insurance and health benefits—rose $3½ billion. While Federal outlays advanced rapidly, receipts remained on a plateau, partly because the slowdown of economic activity automatically held down the tax base. The Federal deficit, which had been $3 billion (annual rate) in the fourth quarter of 1966, rose to a postwar record of nearly $15 billion in the second quarter of 1967. Federal receipts and expenditures, and the accompanying surplus or deficit, are cited throughout this Annual Report as they are recorded in the Federal sector of the national income and product accounts. These measures are closely comparable to the new concept of the "expenditure account," described in *The Budget of the United States Government, Fiscal Year 1969.*

The strongly expansionary fiscal program supported the growth of personal incomes and hence of consumption. Although the saving rate remained high during the first two quarters of 1967, consumer outlays increased $16 billion, nearly matching the growth of disposable income.

The easing of monetary policy in the closing months of 1966 was clearly reflected in the recovery of residential construction in the first half of 1967—a major contrast with its previous rapid decline.

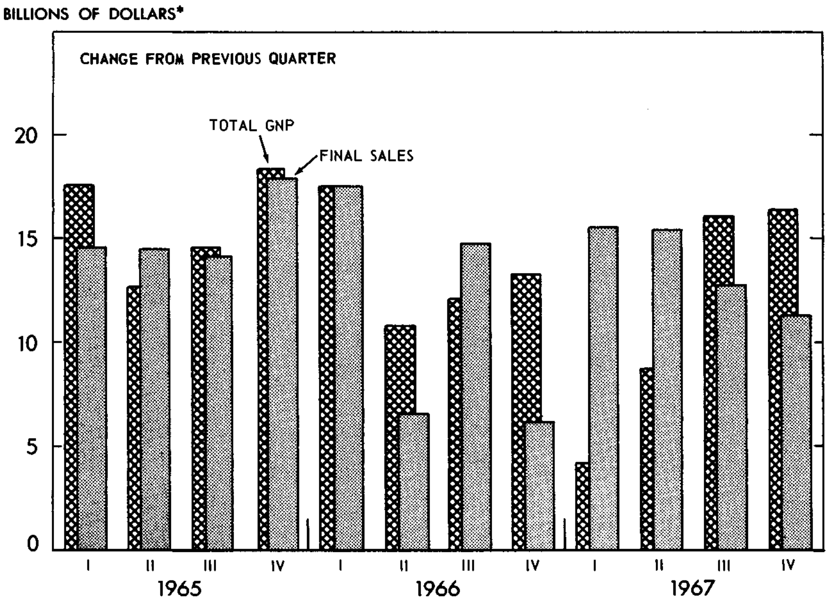
The monetary stimulus during this period came from a deliberately expansionary policy. The fiscal stimulus reflected primarily the continued rapid expansion of defense purchases and rising outlays from previously enacted social insurance legislation. But some discretionary fiscal steps to strengthen expansion were taken—early restoration of the investment tax credit and a rescheduling of some Federal outlays that had been postponed in the fall of 1966.

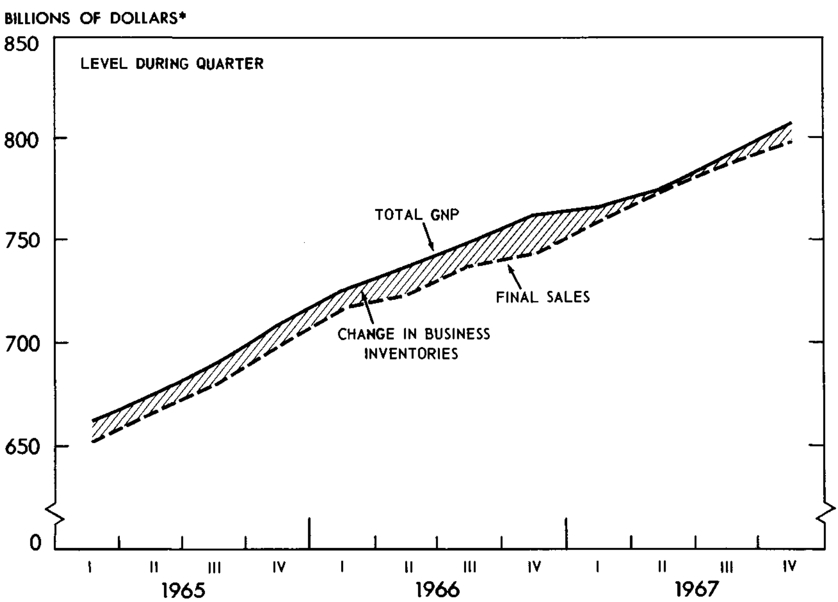
The balance between stocks and final sales improved during the first half of 1967. Inventory investment bottomed out by midyear with no significant liquidation of total stocks and with a continued advance in over-all economic activity.

While the avoidance of recession was a major favorable development, it cannot be read as an indication that the business cycle is dead. On the contrary, the sharp inventory swing showed the continued vulnerability of the economy to cyclical forces. It was only because fiscal and monetary policy were operating in a stimulative direction that the expansion endured.

Chart 1

Total Gross National Product and Final Sales





*SEASONALLY ADJUSTED ANNUAL RATES.
SOURCE: DEPARTMENT OF COMMERCE.

Rebound in the Second Half

The slowdown ended in the spring. Thereafter, the economy maintained a brisk pace for the remainder of 1967. The only marked departure from this course occurred during September and October, when major work stoppages—most notably, the strike at the Ford Motor Company—held activity back.

As sales kept rising and confidence returned, inventory accumulation was gradually resumed. This turnaround accounted for most of the difference in the pace of activity between the first and second halves of the year. Homebuilding outlays continued to rise dramatically, surpassing their 1965 level in the last quarter of 1967. Business fixed investment showed signs of an upturn. Final sales increased substantially, but not as rapidly as in the first half. Federal purchases for defense advanced much more moderately and the growth of consumer spending slowed. The saving rate rose further, in part because of the limited availability of new automobiles in the fourth quarter.

GNP rose $32½ billion from the second to the fourth quarter. In real terms, the advance was 4½ percent (annual rate). The Ford strike held down the rise in GNP by an estimated $4 billion and curtailed the annual rate of real growth by 1 percentage point over this period.

As strikes were settled at Ford and elsewhere, the economy ended the year on a strong note. Industrial production displayed an especially vigorous upsurge and finally surpassed its earlier peak of December 1966. According to preliminary data, the new orders and shipments of durable goods manufacturers rose by 12 percent and 13 percent, respectively, over the final two months of 1967, and exceeded the all-time monthly records set in 1966. Over the same two months, personal income increased by $12 billion and nonfarm payroll employment rose by 900,000. To a large extent, the extraordinary size of these gains represented post-strike recovery rather than underlying growth forces. Nevertheless, the economy was advancing rapidly as 1968 began.

THE COMPOSITION OF OUTPUT

Shifts in the pattern of demand among major sectors of the private economy in 1967 generally worked toward restoring the balance that had been upset in 1966. The years 1961–65 had been characterized by a remarkably balanced expansion among the various sectors: Inventories advanced in line with sales; business fixed investment, though rising rapidly in 1964 and 1965, was geared appropriately to the expansion of markets; homebuilding rose to a high level, which was maintained for an unusually long period; net exports advanced strongly; and consumer spending kept pace with rapidly growing incomes.

In 1966, however, this orderly pattern was interrupted. In particular, marked imbalances arose in the various areas of investment. Business capital spending continued to rise rapidly, and began to add to capacity at a rate

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exceeding the long-term sustainable growth of demand. Inventory investment reached record levels, and stocks outpaced sales. Residential construction declined sharply as the flow of mortgage credit dwindled. Net exports slipped badly as consumers and business turned to foreign sources for products which the domestic market could not supply.

INVESTMENT SECTORS

The economy became better balanced as the composition of investment moved toward a more normal pattern (Chart 2).

Business Fixed Investment

Business fixed investment has averaged 9.8 percent of GNP during the entire post-Korean period. The share rose from the beginning of 1964 to the end of 1966, ultimately reaching a peak of 10.9 percent. The unusually sharp increase in plant and equipment expenditures was finally ended by the slowdown in over-all expansion, the suspension of the investment tax credit in the fall of 1966, and monetary stringency. Business capital spending dipped a little for a time, but it remained essentially on a high plateau in 1967. By yearend, its share had fallen to 10.4 percent of GNP.

Inventory Investment

During the past 15 years, inventory investment has fluctuated markedly around an average level of 1 percent of GNP. As noted earlier, it accelerated sharply in 1966 to reach the unsustainable rate of 2.4 percent of GNP at yearend. In the second quarter of 1967, inventory investment was negligible. It recovered thereafter, reaching a rather normal 1.1 percent of GNP in the fourth quarter.

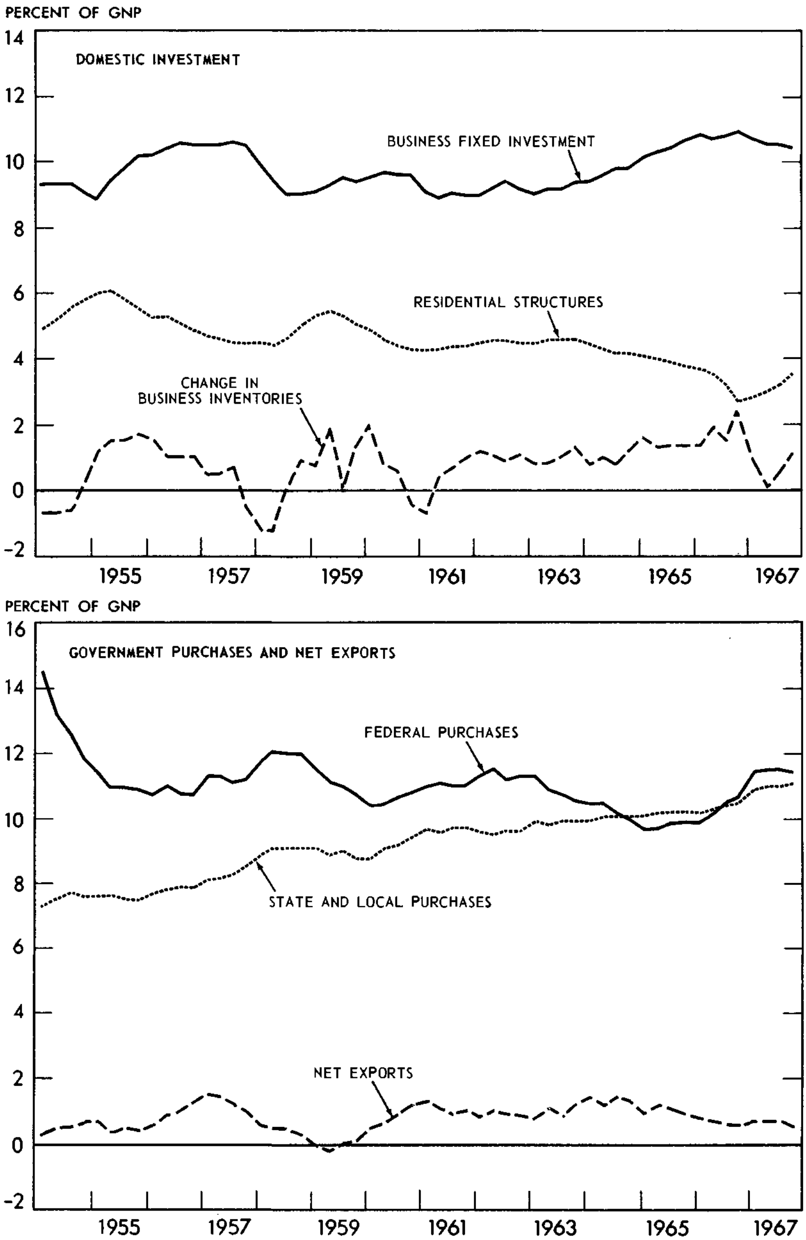
Residential Construction

During the period 1961–65, expenditures on residential construction activity averaged 4.3 percent of GNP, and private nonfarm housing starts averaged just under 1.5 million units a year. As a result of monetary tightness, homebuilding declined sharply during 1966, with housing starts falling to an annual rate of 0.9 million units in December. Residential construction expenditures fell from 3.7 percent of GNP in the first quarter to a low of 2.7 percent in the fourth quarter.

The year 1967 witnessed a steady and spectacular recovery in residential construction, reflecting renewed availability of mortgage financing and strong underlying demand. By the fourth quarter, the share of homebuilding in GNP had increased to 3.5 percent.

Chart 2

Selected Shares of Gross National Product



NOTE.–BASED ON SEASONALLY ADJUSTED DATA.
SOURCE: DEPARTMENT OF COMMERCE.

Net Exports

Exports of goods and services exceeded imports by an average of 1.1 percent of GNP during the 1961–65 period. Demands for imports rose sharply in 1966, and the share of net exports in GNP dropped to a low point of 0.6 percent in the fourth quarter of 1966. During the first three quarters of 1967, net exports recovered somewhat and averaged 0.7 percent of GNP. In the fourth quarter, however, a disturbing new decline in net exports was registered, as sluggishness of demand abroad held U.S. export sales on a plateau, while the economic rebound at home generated a renewed growth of imports.

GOVERNMENT

Purchases of goods and services by State and local governments have risen steadily and rapidly during the post-Korean period, supported in part by the strong expansion of Federal grants-in-aid. State and local purchases amounted to 7.5 percent of GNP in 1954, advanced to 9.7 percent in 1961, increased further to 10.4 percent in 1966, and reached 11.1 percent of GNP in the fourth quarter of 1967. The total growth of State and local purchases has been fairly steady. But employment has accelerated in recent years, with increases of nearly 600,000 workers in both 1966 and 1967. State and local payrolls absorbed about two-fifths of the growth in the total civilian labor force in these two years.

Federal purchases of goods and services have shown much more erratic movements, reflecting marked shifts in defense requirements. As a share of GNP, they reached a post-Korean low of 9.7 percent in the second quarter of 1965, but have been rising since then because of the conflict in Vietnam. Still, by standards of earlier years, Federal purchases as a share of GNP are currently not particularly high. In the fourth quarter of 1967, they amounted to 11.4 percent of GNP, not much different from the 11.1 percent average share in 1955–61 and far below the 15.7 percent share at the close of the Korean war.

PERSONAL SAVING

Beginning in the fourth quarter of 1966 and persisting throughout 1967, individuals have been saving an especially large share of their after-tax incomes, and thus have been spending a reduced share on consumer goods and services. At current income levels, an increase of 1 percentage point in the saving rate corresponds to a $5½ billion reduction in consumer spending. The ratio of personal saving to disposable personal income was 7.1 percent in 1967. Table 2 shows that this is unusually high by standards of recent years, although not in comparison with 1956–58. In the analysis of current data, it must be recognized that revisions in the national accounts have, at times in the past, markedly changed the initial estimates of the saving rate. But other statistical evidence also suggests that saving in 1967 was much higher than in previous years.

TABLE 2.—*Disposition of disposable personal income in selected periods, 1956–67*

[Percent]

Category	1956–58 average	1959–64 average	1965	1966	1967 [1]
Disposable personal income	100.0	100.0	100.0	100.0	100.0
Personal consumption expenditures	91.1	92.2	91.7	91.6	90.3
Durable goods	12.8	13.0	14.0	13.8	13.2
Autos and parts	5.4	5.7	6.3	5.9	5.4
Other durables	7.3	7.3	7.6	8.0	7.9
Nondurable goods	44.0	42.3	40.5	40.8	39.9
Food and beverages	23.9	22.3	21.0	21.0	20.3
Other nondurables	20.1	19.9	19.5	19.8	19.6
Services	34.3	37.0	37.3	37.0	37.1
Interest paid and transfer payments to foreigners	2.1	2.3	2.5	2.6	2.6
Saving	6.9	5.5	5.8	5.9	7.1

[1] Preliminary.

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

Sources: Department of Commerce and Council of Economic Advisers.

A significant part of the rise in the saving rate in 1967 may be attributable to a decline in the proportion of disposable income spent on automobiles from an average of 6.0 percent in 1963–66 to 5.4 percent in 1967. The proportion in 1963–66 seems unusually high, and the decline in 1967 may be partly the backwash of that earlier experience. Moreover, it is quite normal in light of past performance for a decline in the share of income spent on autos to be associated with a rise in the saving rate.

A variety of other factors, many of them short run in character, may also have influenced saving. The recent increase in the saving rate may have been caused, in part, by the Medicare program introduced in mid-1966. This program contributed $4 billion to disposable income in 1967. Some part of these benefits must have covered health care which otherwise would have drawn down personal saving.

Developments in financial markets may also have affected saving. During 1966 households bought large amounts of bonds; as a result, the growth in their holdings of liquid assets—such as currency, demand deposits and saving deposits—was curtailed. During the course of 1967, however, consumers rebuilt their liquidity at a rapid rate. To a degree, this was accomplished by a shift in the composition of financial assets away from less liquid types of securities, but in part the additional liquidity may have been accumulated through increased saving.

Some economists have also suggested that consumer saving is likely to be unusually high in the period immediately following an acceleration of prices. They cite 1948, 1951, and 1952 as precedents.

While few of these factors would imply a permanently higher saving rate, past evidence indicates that a reversion to a more normal rate is most likely to occur gradually rather than abruptly.

BALANCE OF SAVING AND INVESTMENT

The shift in saving and investment demands in 1967 can also be viewed in terms of the balance of total investment and saving in the aggregate economy.

The difference between gross private investment and gross private saving is, in principle, always matched by the surplus or deficit of Federal, State and local governments. In fact, a statistical discrepancy generally creeps into the measurement of these flows and prevents complete realization of the definitional equality (Table 3).

In 1966, despite its unbalanced composition, gross private investment amounted to 16.2 percent of GNP, a quite typical share for a full employment year. It exceeded the total saving of individuals and corporations by a small margin. This small excess of private investment over private saving was essentially matched by the moderate surplus of State and local governments. Federal receipts, meanwhile, virtually equalled expenditures; thus the Federal Government neither drew down nor added to total national saving.

TABLE 3.—*Gross saving and investment in selected years of relatively high employment, 1952–67*

Source or use of saving	Percent of gross national product				
	1952	1956	1965	1966	1967 [1]
Private sector:					
Gross investment	14.9	17.1	16.3	16.2	14.5
Business fixed investment	9.1	10.4	10.4	10.8	10.5
Residential structures	5.0	5.2	3.9	3.3	3.1
Change in business inventories	.9	1.1	1.4	1.8	.6
Net foreign investment	−.1	.4	.6	.3	.3
Gross saving	15.4	16.2	16.2	16.1	16.5
Personal saving	5.2	4.9	4.0	4.0	4.9
Gross business saving	10.2	11.3	12.2	12.1	11.5
Excess of private saving or investment (−)	.5	−.9	−.1	−.1	1.9
Government sector:					
Federal surplus or deficit (−)	−1.1	1.4	.2	(2)	−1.6
State and local surplus or deficit (−)	(3)	−.2	.2	.4	(3)
Government surplus or deficit (−)	−1.1	1.2	.4	.4	−1.6
Statistical discrepancy	.6	−.3	−.3	−.3	−.3

[1] Preliminary.
[2] Less than 0.05 percent.
[3] Less than −0.05 percent.

Sources: Department of Commerce and Council of Economic Advisers.

For the year 1967, however, gross private investment amounted to an unusually low 14.5 percent of GNP. Inventory accumulation, residential building, and net foreign investment were all below their average shares of recent years. Meanwhile, personal saving was unusually large as a share of GNP. While a drop in the share of gross business saving provided a partial offset, total private saving as a share of GNP still rose in 1967. The resulting large excess of private saving over private investment implied a comparable major swing toward deficits in the Government sectors. The surplus of State and local governments vanished, and the Federal sector recorded a deficit amounting to 1.6 percent of GNP.

The expansionary fiscal position helped to offset the weakness of private demand and thus to maintain the economy at essentially full employment. If fiscal and monetary policies had been less expansionary, the sag in private demand would have lowered output, employment, and incomes; saving and investment would then have come into balance at lower levels of economic activity.

As the 1967 experience demonstrates, under conditions of unusual weakness in private demand, a large Federal deficit at full employment can help to sustain total demand at an appropriate level. Table 3 also contains the data for 1952, which was similar to 1967 in this respect. But, under conditions of strong private demand, a similarly expansionary budget would be inappropriate, causing inflationary pressures and requiring monetary restraint to curb investment demand. Some of the major factors operating to produce the excess of private saving in 1967 were clearly temporary; these included the inventory overhang at the beginning of the year and the lingering impact of tight money on residential construction. The relative weakness of private demand in the first half of 1967 gave way to growing strength in the latter part of the year, and this is continuing into 1968.

RESOURCE USE IN 1967

Although real GNP increased only 2½ percent from 1966 to 1967, the average unemployment rate did not rise. The growth of the economy's supply capabilities generally allows output to increase about 4 percent per year with constant utilization rates. A growth of actual output much below that rate would normally be expected to be accompanied by a rise in the unemployment rate. But this did not occur last year.

Much of the production slowdown early in the year was reflected in a decline of average hours worked per man rather than in a reduction of employment. For 1967 as a whole, average hours worked per man in private nonfarm employment were 1.3 percent below the high level of 1966. Firms correctly viewed the slowdown as temporary and they were reluctant to release the skilled labor which had been so difficult to find in 1966.

For the private economy, man-hour productivity appears to have risen only 1.4 percent in 1967. A decline in utilization rates normally holds down the growth of productivity. Moreover, business firms were apparently still making up shortages of professional and managerial workers. For example, employment of nonproduction workers in manufacturing grew 1.7 percent in the first half of the year when output was falling.

Labor Force

The unemployment rate for 1967 as a whole was held down by the shortened workweek and the slowdown in the rate of productivity growth, even though the growth of the labor force exceeded normal demographic trends by a wide margin.

From the fourth quarter of 1966 to the second quarter of 1967, there was a moderate decline in the number of women in the labor force and the total civilian labor force grew only slightly. As the pace of economic expansion quickened in the second half, an unusually large number of women entered the labor force and the expansion of adult female employment accounted for over 80 percent of the increase in total civilian employment. This parallel movement of labor force participation and employment is the chief reason why the unemployment rate did not rise significantly in the first half nor decrease notably in the second half.

It should be noted that the unemployment data for 1967 are difficult to interpret and to compare with former years because of the introduction of an improved questionnaire in the monthly survey of employment. There is some evidence that the new procedures may result in a measured unemployment rate slightly below that yielded by the old questionnaire. Thus it is possible that, on a strictly comparable basis, unemployment would have registered an increase of about 0.1 percent of the labor force from 1966 to 1967.

As shown in Table 4, there were only small changes in the demographic and occupational patterns of unemployment rates in 1967. The unemployment rate of nonwhite men continued the steady decline that has taken place since 1961—although the rate is still more than twice that for white men. The unemployment rate increased somewhat for adult females, both white and nonwhite. It also rose further for nonwhite teenagers, the only group that has not experienced a significant decline in unemployment since 1961.

The burden of unemployment remains rather heavily concentrated among nonwhites, who represent 21 percent of the unemployed, but only 11 percent of the employed. Many of these workers suffer particularly from discrimination, lack of education, and inadequate skills and experience. Much of the unemployment in other groups stems from short layoffs, voluntary quits, and—particularly in the case of women and teenagers—from frequent temporary movements into the labor force.

Many workers did have difficulty in finding jobs in 1967, but many employers were still having recruiting problems, even though the labor market was less strained than in 1966. While there was room for an increase in the workweek at the end of the year, labor markets were not generally characterized by excess supplies of labor.

TABLE 4.—*Employment and unemployment by demographic and occupational groups, selected years, 1961–67*

Group	Unemployment rate (percent) [1]				Percentage distribution of employment status, 1967	
	1961	1965	1966	1967	Employment	Unemployment [2]
Total	6.7	4.5	3.8	3.8	100.0	100.0
Demographic groups:						
White	6.0	4.1	3.3	3.4	89.2	78.6
Teenagers	15.3	13.4	11.2	11.0	6.9	21.3
Adult males	5.1	2.9	2.2	2.1	53.8	29.1
Adult females	5.7	4.0	3.3	3.8	28.6	28.1
Nonwhite	12.4	8.1	7.3	7.4	10.8	21.4
Teenagers	27.6	26.2	25.4	26.4	.8	6.9
Adult males	11.7	6.0	4.9	4.3	5.8	6.5
Adult females	10.6	7.5	6.6	7.1	4.2	8.1
Occupational groups:						
White collar workers	3.3	2.3	2.0	2.2	46.0	29.6
Blue collar workers	9.2	5.3	4.2	4.4	36.7	49.8
Service workers	7.2	5.3	4.6	4.5	12.5	17.3
Farm workers	2.8	2.6	2.2	2.3	4.8	3.3

[1] Number unemployed in each group as percent of labor force for the group.
[2] Distribution by occupational groups relates to experienced workers.

Note.—Data relate to persons 16 years of age and over.
Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

Capacity Utilization

In contrast with employment of manpower, plant and equipment utilization in manufacturing was markedly reduced in 1967 from the strained conditions of 1966. Average operating rates fell from more than 90 percent in 1966 to 85 percent in 1967, as manufacturing capacity grew by 6½ percent while output barely increased for the year as a whole. The decline in utilization was limited to the first half of 1967—except in the case of the automobile industry where output was heavily affected by strikes. From June to December, total manufacturing production increased at an annual rate of 8½ percent, outpacing the growth of capacity; at yearend, operating rates were rising in most manufacturing sectors.

PROSPECTS AND POLICIES FOR 1968

At the end of 1967, the economy was in a strong position to move into its eighth year of uninterrupted expansion. As noted above, the composition of demand is now fairly well balanced with that of supply.

Because some slack developed during 1967, real GNP can rise in 1968 by somewhat more than 4 percent without straining resources. But a growth of demand much above that rate would tend to accelerate the increase of wages and prices. An excessive rate of growth of demand could also upset the balance among the sectors of the economy by generating a surge of business investment, and ultimately placing renewed pressures on the capital goods industries. The financial conditions which would inevitably be associated with such developments would again severely depress homebuilding. And a new wave of imports would impair the needed improvement in the U.S. balance of payments.

In 1968, the main objectives of fiscal and monetary policy are to sustain economic expansion, to maintain reasonable balance between demand and resources in the economy as a whole and among its major sectors, to promote a return toward over-all price stability, and to support progress toward balance-of-payments equilibrium.

FEDERAL FISCAL PROGRAM

Federal expenditures in 1968 are expected to rise by about $15 billion, considerably less than the $21 billion increase of last year. Defense purchases, including military pay increases, are scheduled to rise only $4 billion as compared with $12 billion in 1967. The remaining increases in expenditures cover requirements under existing law and provide for high priority civilian programs. Nondefense purchases, also including pay increases, will rise $2 billion. Medicaid, manpower training, and housing and community development programs will add to the total of grants-in-aid in 1968.

A scheduled increase in social security benefits in March will add $3 billion to transfer payments for the year 1968. This increase will be offset, in large part, by a $2 billion rise in payroll taxes, which became effective January 1. Reflecting continued growth of Medicare health benefits and ongoing retirement pensions as well as the new social security programs, total transfers to persons should rise $5 billion.

Excluding the scheduled changes in social security benefits, the remaining expected increase in Federal expenditures is approximately equal to the normal annual growth of Federal revenues at existing tax rates. Thus, in the absence of tax rate increases, the Federal deficit would change little from its estimated level of $12½ billion for 1967. It would remain overly expansionary in relation to the expected growth of private demand.

Accordingly, the President has again asked Congress to enact a temporary 10-percent surcharge on personal and corporate income taxes, effective April 1 for individuals and January 1 for corporations. The proposed surcharge will yield an estimated $8 billion of additional revenues in 1968. The President is also recommending the retention of certain excise taxes, now scheduled to expire in April, in order to avoid a revenue loss of nearly $2 billion in 1968. With the President's tax program, the Federal deficit will be reduced to an estimated $5 billion for the calendar year. Thus the proposed tax changes will eliminate much of the expansionary thrust of the Federal budget as private demand continues to grow. The President's tax proposals are discussed in detail in Chapter 2.

Assuming enactment of the President's fiscal program early in the current legislative session, GNP for 1968 is expected to approximate $846 billion—given the $785 billion now estimated for 1967. This projection, of course, is intended to represent the midpoint of a range of possible outcomes, rather than a precise estimate. After correction for an anticipated over-all price increase somewhat in excess of 3 percent, the midpoint estimate would imply an increase of somewhat more than 4 percent in real GNP. With this output increase and an expected growth of 1¾ percent in the civilian labor force, the unemployment rate for the year as a whole should be essentially unchanged from its current level.

Just as it was evident a year ago that 1967 had inherited a slow start from the conditions which prevailed at the end of 1966, it is equally clear now that 1968 has inherited a running start from the economic conditions of the closing months of 1967. Automobile production schedules for the beginning of 1968 are exceptionally large. The latest surveys of business plans for plant and equipment and the recent strength of new orders for machinery and equipment both point to an advance in business investment in the first half. There is also evidence that a buildup of steel inventories has already begun in anticipation of labor negotiations. Most of the catchup in automobile production is expected to be concentrated in the first quarter and the steel stockpiling in the first half.

Although the rate of advance may be excessive in the early part of 1968, prompt enactment of the President's tax proposals will insure moderate and appropriate expansion after midyear.

When the prospective pattern of economic activity is uneven, forecasting involves special uncertainties. One year ago, the Council foresaw an uneven pattern of activity for 1967, with an advance of $47 billion in GNP for the year as a whole. The actual gain was $5 billion smaller. Nevertheless, the Council did project a slowdown in the first half, followed by a marked rebound in the second. Developments during the year generally corresponded to this pattern.

The ability of economists to forecast is far from perfect, but a projection carefully distilled from the available evidence is indispensable in the formulation of economic policy.

OUTLOOK BY SECTORS

The over-all outlook can be better understood by examining the major expenditure categories.

Business Fixed Investment

The recovery of business fixed investment which seems to have begun late in 1967 is likely to continue at a moderate rate throughout 1968. In the most recent Commerce-SEC investment survey—the results of which are in substantial agreement with other yearend surveys—business firms in utilities, airlines, and a few manufacturing sectors including nonelectrical machinery reported plans for considerable increases in investment in the first half of 1968. Responding to some improvement in operating rates and profits in the first part of the year, other manufacturing industries—currently planning little change in outlays for the first half of 1968—may be expected to raise their investment outlays later in the year. For the year as a whole, the gain over 1967 is expected to be about $4 or $5 billion.

Business Inventories

For 1967 as a whole, inventory accumulation is estimated at only $5 billion. Inventory accumulation in the first half of 1968—spurred by the rebuilding of automobile stocks and forward buying of steel inventories—might run at twice the 1967 rate. The accumulation rate should be approximately normal in the second half of 1968, so that, for the year as a whole, the net addition to stocks is expected to total several billion dollars above that of 1967.

Homebuilding

Provided the tax increase is enacted early in 1968, the relief of pressures on financial markets should be sufficient to permit continued growth in residential building. Private nonfarm housing starts in 1968 are expected to exceed 1½ million for the first time since 1964—a substantial increase over 1967, though still below the basic demand of our expanding population. Expenditures on homebuilding and modernization of existing residences should rise through the year, and, for 1968 as a whole, exceed 1967 outlays by $5 to $6 billion.

The events of 1967 have shown quite clearly that housing demand is strong enough to support a high and rising level of building even when mortgage interest rates are high—provided funds are available at thrift institutions. Over the past 12 to 15 months, the monetary authorities—as explained in Chapter 2—have been especially mindful of the need to provide financial support for building activity. If they are able to maintain this course, residential building will continue to be an important stimulus to general economic expansion while providing the improved housing capacity needed in many areas of the country.

Government

Purchases of goods and services by State and local governments should rise by $8 or $9 billion in 1968. Here, too, part of the expected growth is dependent on the existence of financial conditions that will permit State and local governments to carry out planned construction projects.

For the year as a whole, Federal purchases are expected to rise by $6 billion. The quarterly pattern of advance during the year is expected to be fairly smooth, except that the third quarter rate will be enlarged by a Federal pay increase estimated at $1½ billion (annual rate). The timing of this bulge should serve to offset some of the effect on aggregate demand of the reduction in inventory accumulation expected in the second half of the year.

Consumption

An expected gain of about $35 billion in disposable income—consumer income after tax *and surtax*—should promote a sizable advance in consumer spending. Recent increases in consumer liquidity should reinforce the gains in income. Expenditures on household durables should receive particular support from the continued high level of homebuilding. Another contributing element is the prospective catchup in automobile sales.

For 1968, the consumer sector is clearly an area of particular uncertainty in forecasting private demand. As noted above, the saving rate has been unusually high for the past five quarters. And the latest evidence indicates that consumers are still spending cautiously. Nevertheless, the weight of past evidence would suggest that, following a period of abnormally high saving, the most likely possibility is a gradual decline in the saving rate.

The saving rate implicit in the projection of an $846 billion GNP is only slightly below the 7.1 percent rate of 1967. The automobile catchup essentially accounts for the small projected decline. On this basis, consumer spending is expected to rise about $33 billion in 1968.

With the prompt enactment of the President's tax proposals, the prospects outlined above suggest that, while price increases will continue to be troublesome, the U.S. economy should experience healthy and balanced economic growth in 1968.