JANUARY 1961

Economic Report of the President

TRANSMITTED TO THE CONGRESS

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LETTER OF TRANSMITTAL

THE WHITE HOUSE,
January 18, 1961.

To the Congress of the United States:

I present herewith my Economic Report, as required by Section 3(a) of the Employment Act of 1946.

The Report was prepared with the advice and assistance of the Council of Economic Advisers, who, in turn, have had the assistance of the heads of the executive departments and independent agencies directly concerned with the matters discussed. Pursuant to the requirements of the Employment Act, the Report summarizes the economic developments of the year and the policy actions taken to promote balanced growth of the economy, appraises the economic outlook, and puts forward a number of legislative proposals designed to help achieve the purposes of the Act. The Report also reviews the performance of the economy under the Employment Act, and particularly during the period of this Administration, and discusses policies for the future in the light of this experience.

The major conclusions and recommendations of the Report are set forth below, in part in the words of the Report itself.

As the year 1960 came to a close, the Nation was producing goods and services at an annual rate of $503.5 billion, the same as in the third quarter of the year, though slightly less than in the second quarter. For the year as a whole, the total output of our economy, in dollars of constant buying power, was 2.6 percent greater than in 1959.

Production and employment declined in the latter part of 1960, and unemployment rose, owing in large measure to an inventory adjustment. In the first quarter, inventories were being built up at an annual rate of $11.4 billion, but in the fourth quarter they were being reduced at an annual rate of $4.0 billion. It is encouraging, however, that the declines in production and income were moderate. And it is especially important that final demands for goods and services—that is, the sum of the Nation's expenditures except those resulting in inventory change—rose without interruption during the year and in the final quarter reached the level of $507.5 billion.

The achievement of a reasonable equilibrium in the Nation's international transactions continued to be a goal of our policies in 1960. The over-all deficit in the United States balance of payments last year remained close to that in each of the two preceding years, but the structure of the deficit changed markedly. Short-term capital outflows accelerated, mainly in response to a widening of the margin by which interest rates abroad exceeded those in this country. But the deficit on all other transactions diminished greatly, as a result of a rapid rise in exports.

The underlying strength of our economy, manifested in final demand for goods and services, is a distinctly favorable element in appraising the economic outlook. So, also, is the fact that economic conditions today are free of maladjustments and imbalances which, to be corrected, would require prolonged contraction. Businessmen and consumers have kept their use of credit within reasonable limits, and speculative excesses have been generally avoided. Inflationary pressure has been restrained. While this may have affected inventory policies and, perhaps, other demands for goods and services, it has helped to prepare a solid foundation for a resumption of sustainable growth. Because action to maintain balance and to consolidate gains was taken in good time, we can look forward, provided public and private policies are favorable, to a period of sound economic growth from a firm base.

The Federal policies needed to promote balanced growth can, to a considerable extent, be applied under existing administrative authority. But there are certain areas in which legislative action is needed.

First, funds appropriated by the Congress for the fiscal year 1962 should be held within the limits of expected revenues. A budget conforming to this standard has been presented to the Congress. It makes certain suggestions for revenues to cover projected expenditures, including necessary extensions of taxes that would otherwise terminate or be reduced on July 1, 1961; an increase in the highway fuel tax to 4½ cents per gallon, to supply needed funds in the Highway Trust Fund; the rescinding by the Congress of action taken in 1959 which would divert funds from the general fund of the Treasury for road construction; and a rate increase to place the postal system on a self-supporting basis.

Second, Congress should give the Secretary of the Treasury authority to raise funds in the long-term capital market when, in his judgment, this is in the public interest, even if the cost of the funds is above 4¼ percent. The existing ceiling remains an important impediment to the Treasury's flexibility in achieving significant debt lengthening.

Third, as I have pointed out to the Congress each year since 1955, legislation is needed to enable the Federal Government to give constructive assistance to areas where there is high and persistent unemployment. The character of the legislation needed is described in the Economic Report, and an Administration proposal drafted to meet the standards indicated has been placed before the Congress.

Fourth, legislative needs in the areas of health, education and welfare, antitrust enforcement, long-term agricultural adjustment, unemployment compensation, and housing and community development are outlined in the Report. These are also described in the Budget Message.

Finally, I recommend again that Congress amend the Employment Act of 1946 to make reasonable price stability an explicit goal of national economic policy, coordinate with the goals of maximum employment, production, and purchasing power now stated in the Act. The amendment proposed is limited to a change in the language of the Act's declaration of policy and would accomplish its aim without placing restrictions on the effective operation of economic markets. It would strengthen the Employment Act which, as the Economic Report shows, has been a useful statute under which our citizens have made notable further advances in their welfare.

DWIGHT D. EISENHOWER.

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INTRODUCTION

This Economic Report is the eighth prepared by this Administration pursuant to the provisions of Section 3(a) of the Employment Act of 1946. Since the eight Reports cover a period that embraces more than half of the lifetime of the Act, the present occasion seems an appropriate one for a brief survey of the performance of our economy since 1946 and an exploration of the challenges and opportunities of the years ahead. Accordingly, these topics are treated here, as well as the required review of 1960 and the examination of issues that will more immediately concern the new President and the new Congress.

The first chapter in the Report reviews the outstanding economic developments of 1960, describes the policies pursued by the Federal Government during the year to help achieve the purposes proclaimed in the Employment Act, and appraises the economic outlook for the next year. The second chapter considers the Nation's economic performance during the entire period since 1946, and in particular during the eight years spanned by the present Administration. In the light of this experience we can appreciate more fully the vigor of the American economy and its promise for further improvement of the welfare of our citizens. The third chapter identifies major problem areas to which attention should be directed in the future and for which effective policies and programs should be devised within our proven economic, political, and social framework. In addition, Chapter 3 presents proposals for the legislation needed to help achieve the purposes of the Employment Act. These include some items which were presented in last year's economic program of the Administration and on which action has not yet been taken; they merit renewed consideration in the current economic context.

It is not amiss here to mention an observation made several times in this Report: the history of the past 15 years offers a solid basis for confidence in the continued efficacy of the American system of complementary private and public endeavor. This concept of shared responsibility for economic growth and improvement, so clearly reflected in the declaration of policy of the Employment Act, points the way to sound achievement, in a changing domestic and international environment, of the common economic purposes of all Americans.

Chapter 1

Economic Developments and Policies in 1960

EMPLOYMENT, production, and income in the United States attained in 1960 levels well above those of 1959. The advances, however, were concentrated in the first half of the year; in the second half, production and employment declined and unemployment rose. For the year as a whole, the gross national product in current prices was 4.4 percent higher than in 1959; in constant prices, the increase was 2.6 percent.

The improvement in the first part of 1960 was an extension of the advance that had begun in the spring of 1958; this expansion had been aided by the fact that consumer income and outlays had fallen very little during the preceding contraction. Before mid-1958, personal income began to rise, and consumers increased their spending. These developments helped to restrain, and later to reverse, the severe inventory liquidation that had been in progress. Subsequent impulses came from an upward turn in outlays on residential construction followed by a renewed advance in plant and equipment expenditures. Throughout 1958, Government expenditures for goods and services continued to rise fairly steadily. With a substantial Federal deficit and an easing of monetary policy, the expansion of the economy proceeded vigorously, supported by steadily mounting consumption.

Expansionary forces continued to show strength in 1959, although they were distorted by the effects of the steel strike. As prices began to rise after a year of approximate stability and more serious inflationary pressures threatened, Federal Reserve authorities increased the degree of monetary and credit restraint that had been initially applied in the summer of 1958. Moreover, the gap between Federal cash receipts and expenditures (seasonally adjusted) was being steadily reduced in accordance with the program for a balanced budget.

In the early part of 1959, the rise in economic activity was accelerated by the anticipation of a steel strike and by the further build-up of inventories which this tended to promote. The long strike that marked the second half of 1959 reversed this process in some measure. Inventory investment dropped markedly, and employment and income declined. In response to these developments, the rise in final demands—the sum of the Nation's expenditures on goods and services except those resulting in inventory change—slackened during the second half of 1959. However, with continued strength in the underlying expansive forces, economic activity fell less drastically than might have been expected in the face of this stoppage in one of the major industries of the Nation.

The halting of the steel strike by a Federal court injunction in November brought an upsurge in economic activity. Steel users rushed to rebuild depleted inventories, and automobile production was stepped up sharply. By the end of 1959, demands that had accumulated during the strike led to widespread expectations of a strong boom and further inflationary pressures.

Fears of inflation, however, were lessened by other developments. Monetary authorities had brought credit expansion under effective control. The budget proposed for the fiscal year 1961 showed a substantial surplus. The terms under which the steel strike had been halted were believed to be favorable to stable prices for steel and other products; and the competition from abroad that was felt by a widening range of American industries also served as a restraint on prices. Inventories were restored rapidly in early 1960, and industrial capacity generally was found to be ample.

As 1960 progressed and as stocks approached or exceeded the volume deemed appropriate to the sales actually experienced, the high rate of inventory investment declined. On the other hand, expenditures for fixed investment and for consumption, as well as the export balance, increased. In the second quarter, gains in final demand outweighed the drop in inventory investment, and gross national product (GNP) continued to advance, albeit more slowly than in the first quarter (Table 1 and Chart 1). Employment and income also showed good gains.

In the second half of the year, expenditures on business plant and equipment, as shown in the Securities and Exchange Commission—Department

TABLE 1.—*Gross national product, 1958–60*

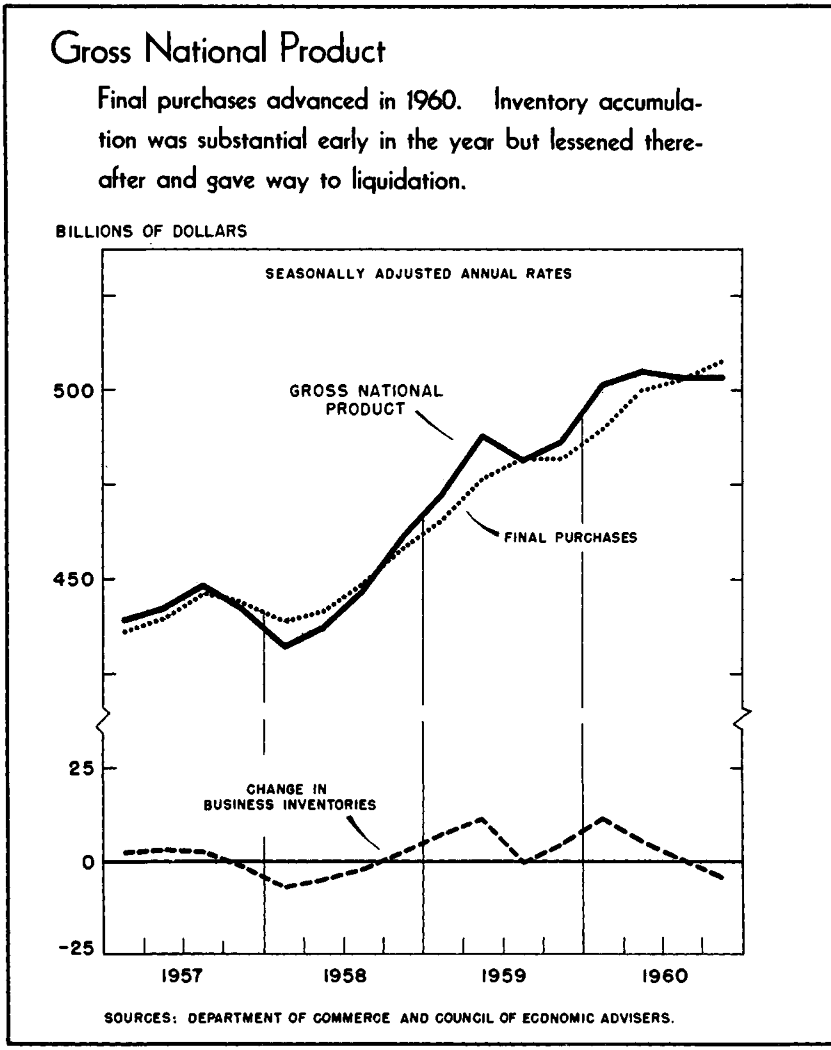
[Billions of dollars, seasonally adjusted annual rates]

Period	Gross national product			Change in gross national product from preceding quarter		
	Total	Final purchases	Change in business inventories	Total	Final purchases	Change in business inventories
1958: First quarter	432.0	438.9	−6.9	−10.3	−4.6	−5.7
Second quarter	436.8	441.3	−4.5	4.8	2.4	2.4
Third quarter	447.0	448.6	−1.6	10.2	7.3	2.9
Fourth quarter	461.0	458.1	2.9	14.0	9.5	4.5
1959: First quarter	473.1	465.5	7.6	12.1	7.4	4.7
Second quarter	487.9	476.4	11.5	14.8	10.9	3.9
Third quarter	481.4	481.5	−.1	−6.5	5.1	−11.6
Fourth quarter	486.4	481.7	4.7	5.0	.2	4.8
1960: First quarter	501.3	489.9	11.4	14.9	8.2	6.7
Second quarter	505.0	499.7	5.3	3.7	9.8	−6.1
Third quarter	503.5	502.9	.6	−1.5	3.2	−4.7
Fourth quarter [1]	503.5	507.5	−4.0	.0	4.6	−4.6

[1] Preliminary estimates by Council of Economic Advisers.

Source: Department of Commerce (except as noted).

CHART 1



of Commerce survey, began to decline, reflecting adequate productive capacity, diminishing profits, and a slowing down in the growth of demand. The advance in consumer expenditures slackened despite a further, though more moderate, rise in disposable income, and the rate of saving increased accordingly. Housing activity continued the decline that had begun in the second half of 1959. Inventory expenditure continued to be a contractive force, as liquidation took place toward the end of the year. These negative factors outweighed the major positive elements of demand—rising exports and Government purchases—and GNP dropped slightly in the third quarter. In the final quarter of the year, however, GNP remained at its third quarter level.

Inventories

The rapid restocking of inventories in the early part of 1960 and the subsequent reversal of this movement were the principal factors shaping the course of the economy during the year. In the first quarter, manufacturers of durable goods accounted for 60 percent of the total inventory accumulation of more than $11 billion (annual rate), and automobile retailers accounted for another 25 percent (Tables 1 and 2). In the second quarter, the build-up continued, but the rate of accumulation was reduced to about $5 billion, as producers found their needs more adequately covered. The steel industry, in particular, accumulated sizable supplies of finished steel and materials during that quarter.

Table 2.—*Changes in book value of manufacturing and trade inventories, 1959–60*

[Billions of dollars, seasonally adjusted annual rates]

Industry group	Change from preceding quarter [1]							
	1959				1960			
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter [2]
Total	5.6	11.0	−0.4	0.8	11.7	4.7	−1.3	−1.3
Durable goods	6.0	8.2	−2.6	−.7	10.3	3.1	−1.9	−2.3
Manufacturing	4.4	5.2	−1.6	1.1	6.7	1.8	−1.6	−3.2
Wholesale	.3	.9	−.3	.3	.9	.5	−.1	−.3
Retail	1.2	2.1	−.6	−2.1	2.7	.7	−.3	1.2
Automotive	1.7	1.9	−.9	−2.3	2.8	.8	−.3	1.4
Nondurable goods	−.4	2.8	2.1	1.5	1.4	1.6	.6	1.0
Manufacturing	.7	1.5	.7	1.1	.9	1.2	.0	.5
Wholesale	−.5	.8	1.0	.2	−.2	.3	.2	.9
Retail	−.6	.4	.5	.3	.6	.1	.3	−.4

[1] Change in book value of inventories at end of periods; differs from net change in business inventories component of GNP which relates to all industries and which includes an adjustment for inventory valuation.
[2] Change from end of third quarter to end of November.

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

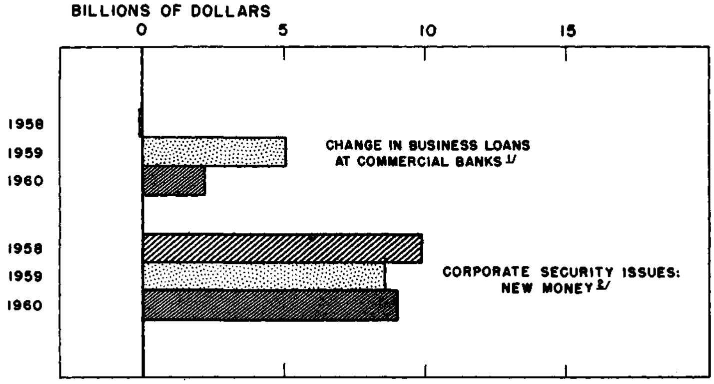
Source: Department of Commerce.

At midyear, total inventories in relation to sales were not large, measured by historical standards. They were more substantial for some durable goods manufacturers and for automobile retailers and relatively less so for many producers of nondurable goods. As early as midyear, there was evidence that manufacturers' inventories of purchased materials, notably steel, were being reduced. Meanwhile, businessmen's holdings of finished products increased further, a development which in part may not have been intended, especially with regard to consumer durable goods lines. As the year progressed, inventory policies in some lines of business underwent modification in response to declining sales, less optimistic expectations, and ample capacity of suppliers in many industries. The reduction in profits provided another incentive for more cautious inventory policies. Additional

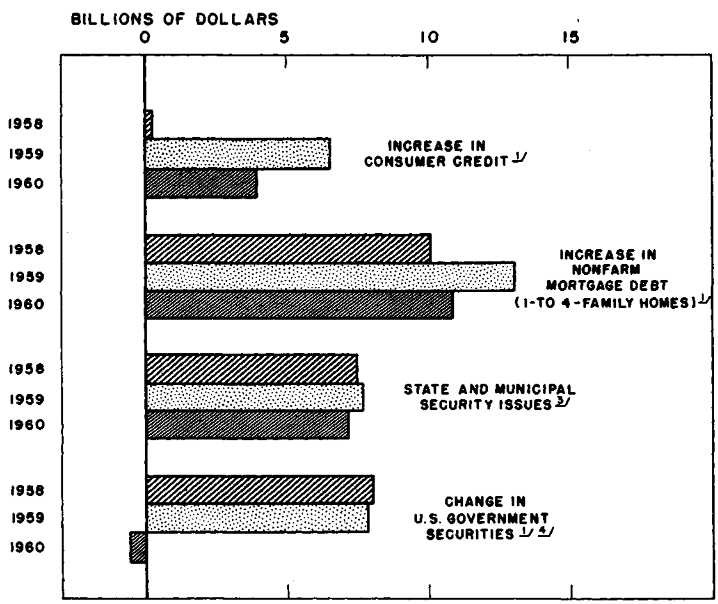
CHART 2

Growth of Credit

The growth in business loans slowed down in 1960, while new issues of securities increased slightly.



There was also less demand for credit by individuals and by various levels of government.



1/ CHANGE IN AMOUNT OUTSTANDING.

2/ NET PROCEEDS.

3/ PRINCIPAL AMOUNTS.

4/ EXCLUDES GUARANTEED SECURITIES.

SOURCES: VARIOUS GOVERNMENT AND PRIVATE AGENCIES.

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contributing factors may have been the greater confidence in price stability and improving techniques of inventory control. As a result, inventory reductions developed in some industries during the third quarter and became more extensive in the final quarter of the year.

The changes in inventory policy were reflected in the business loans of banks (Chart 2). During the early months of the year, bank credit of this type increased more than seasonally, but subsequently, as businessmen slowed their inventory accumulation and later shifted to inventory liquidation, the expansion in credit was reduced markedly. Some easing occurred in the availability of credit, and in August the prime rate for bank loans was lowered from 5 percent to 4½ percent.

Plant and Equipment Expenditures

Outlays for business plant and equipment, as reported by the SEC-Commerce survey, which had started to advance in the fourth quarter of 1958, continued to rise in the first half of 1960, the most significant gain occurring in the manufacturing industries. Total outlays in the six-month period were 13 percent higher than in the first six months of 1959. During the second half of the year, however, these expenditures began to decline. For the year as a whole, they exceeded expenditures in 1959 and approached, but did not quite equal, the record level attained in 1957.

The financing in 1960 of the larger volume of plant and equipment expenditures by corporations proceeded in an environment of generally easing capital markets. Corporations other than sales finance companies relied somewhat less heavily upon new issues of securities than in 1959, although, in the aggregate, offerings were expanded. With lower interest rates, the volume of bond flotations rose substantially. Offerings of stocks, however, declined as stock prices fell. The flow of internal funds appears to have been slightly below that in 1959, because rising depreciation and amortization allowances were not fully sufficient to offset reduced profits. But the expanded capital outlays were met without strain, since requirements for funds to finance additions to inventories were less than in 1959 and liquid holdings of cash and Treasury obligations were used more intensively.

Residential Construction

Expenditures on residential construction in 1960 were 10 percent below those in 1959. The number of new starts dropped somewhat more sharply than expenditures, but the effect of this reduction upon the home building industry was mitigated by the improvement in the volume of activity in additions and alterations.

The decline in housing activity was tempered by an increase in the availability of mortgage credit and, to a much lesser extent, by lowered borrowing costs. Another favorable factor was the rise in income. However, the response to these stimuli was less than in 1958. Vacancy rates in rental units rose from 6.6 percent in the third quarter of 1959 to 7.6

percent in the third quarter of 1960. Reflecting developments in housing activity, outstanding mortgage debt on 1- to 4-family homes rose by $11 billion in 1960, compared with a net increase of $13 billion in 1959.

Net Exports

The mounting favorable export balance was an expansive factor throughout 1960. After showing an excess of imports over exports of $2.2 billion (annual rate) in the second quarter of 1959, the Nation's export balance improved rapidly, and by the fourth quarter of 1960 it was $4.0 billion. Exports of goods and services rose during the year while imports fell slightly. (The balance of payments is discussed in a later section of this chapter.)

Government Expenditures

Government expenditures on goods and services increased throughout the year, and in the final quarter they were $5 billion (annual rate) higher than a year earlier. The rise reflected principally the steady advance in State and local expenditures following their brief decline late in 1959, which was occasioned in part by the impact of the steel strike upon public construction. Government transfer payments and interest, which are not included in expenditures on goods and services, rose from $33.6 billion in the fourth quarter of 1959 to $36.9 billion in the fourth quarter of 1960, thus making a very material contribution to final demand.

Federal expenditures, which had reached a peacetime high of $54.3 billion (annual rate) in the fourth quarter of 1958, fell to $51.7 billion in the second quarter of 1960. Smaller inventory acquisitions by the Commodity Credit Corporation and lower expenditures for defense accounted for most of this drop. However, Federal expenditures began to advance in the second half of the year, owing largely to a pay increase for Government employees and rising defense spending, and reached $53.2 billion in the fourth quarter.

Consumption and Income

Consumer expenditures on services in 1960 continued the rise which has been uninterrupted during the years since the war. However, this long advance reflects in part pronounced and persistent price increases in this sector. Expenditures on nondurable goods were especially strong just prior to midyear, but weakened thereafter, as the rise in consumer income slackened. Outlays on consumer durable goods changed little in the first half of the year and declined in the second half. Sales of domestically produced new automobiles totaled 6.1 million for the year as a whole, a volume unequaled since 1955 though still below industry expectations expressed in the early months of 1960. The increase in volume, however, does not represent a fully proportionate gain in dollar value of sales; for the first time, a considerable part of the total—at least 25 percent—consisted of lower-priced compact cars. Meanwhile, the demand for durable household goods exhibited weakness, reflecting in part the decline in the number of new homes built.

The rise in consumer expenditures was supported by the growth of personal income to a level 5 percent above that of 1959 (Chart 3). However, aggregate consumption in 1960 did not fully keep pace with the increase in individual incomes; consequently, saving increased, as a proportion of income, from 6.6 percent in the strike-affected second half of 1959 to 7.7 percent in the second half of 1960. This increase in the rate of personal saving was another important factor contributing to the declines in the economy during the second half of the year and was reflected in the larger accumulation of liquid assets by individuals, as well as in their more restricted use of credit.

The advance in personal income that accompanied the rise in economic activity during the early part of 1960 became less marked after the middle of the year. Labor income benefited from the rise in basic wage rates of approximately 3 percent per year, reflecting major collective bargaining settlements, deferred wage increases, and cost of living adjustments. However, labor income was adversely affected by a decline in employment which was especially marked in the more highly paid durable goods manufacturing industries, and by a lower average workweek of production workers. After the middle of the year, labor income as a whole rose more slowly and then declined, dropping more sharply as the year ended. Some other forms of personal income—notably interest and transfer payments—continued to increase during most of the year.

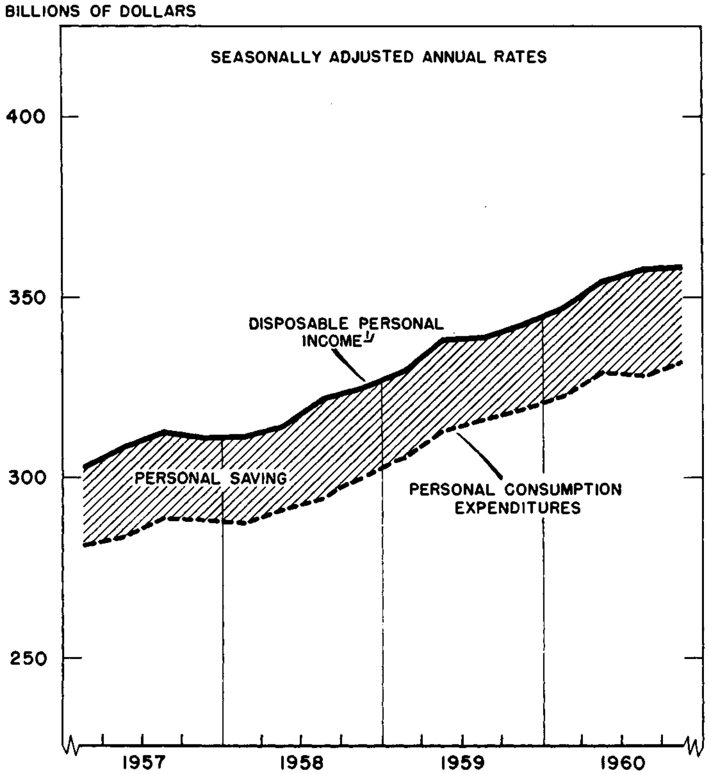
In the first half of the year, consumers made fairly extensive use of instalment credit, causing the total debt outstanding to expand at a substantial rate. Thereafter, the marked slowing down of the rise (seasonally adjusted) was one of the factors that contributed to the increase in the saving rate; for 1960 as a whole, the growth in consumer credit was substantially less than in 1959. While the growth rate in automobile and certain other consumer goods paper fell off markedly from the first to the second half of the year, the rate of growth in personal loans was more nearly maintained.

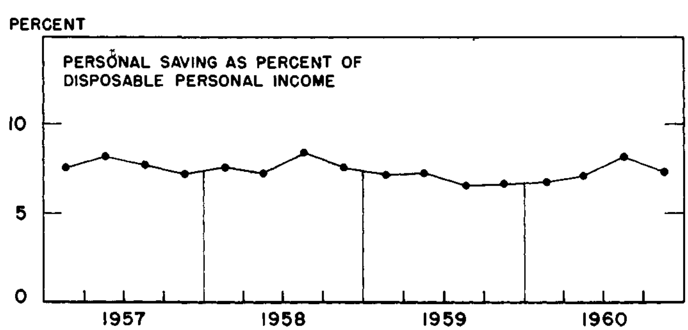
In contrast to personal income, corporate profits declined early in 1960 (Chart 4). In the first quarter, corporate profits before taxes were at an annual rate of $48.8 billion, compared with the record figure of $51.7 billion in the second quarter of 1959, and by the third quarter they had dropped to $41.5 billion. A shift from profits to other forms of income can help sustain a high level of over-all demand in the short run, although over a longer period a shrinkage of profits relative to output may be expected to reduce both the means and the incentive for business investment. In the second half of 1960, however, the higher saving rate largely forestalled the favorable effect that such a shift might have had, through higher consumer income, upon consumer buying.

CHART 3

Personal Income, Spending, and Saving

Disposable personal income rose strongly during the first half of 1960 but more moderately thereafter. Since spending did not keep pace, personal saving tended to rise.

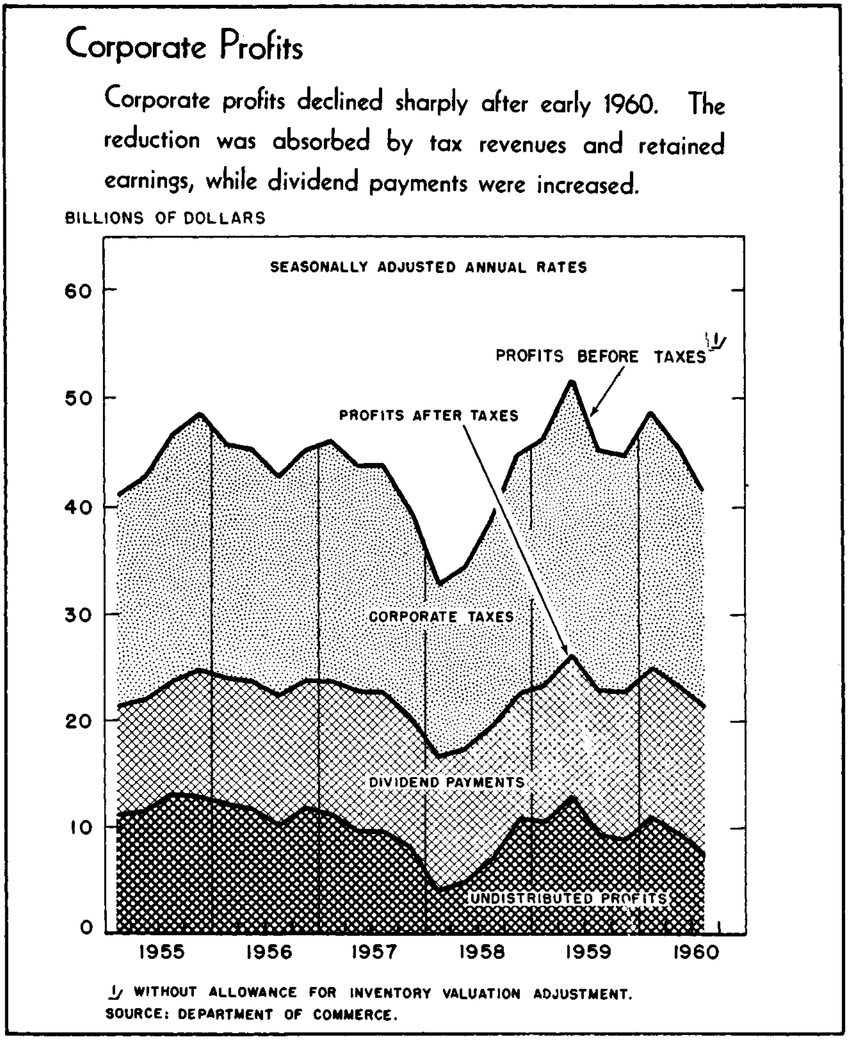




[1] PERSONAL INCOME LESS TAXES.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

CHART 4



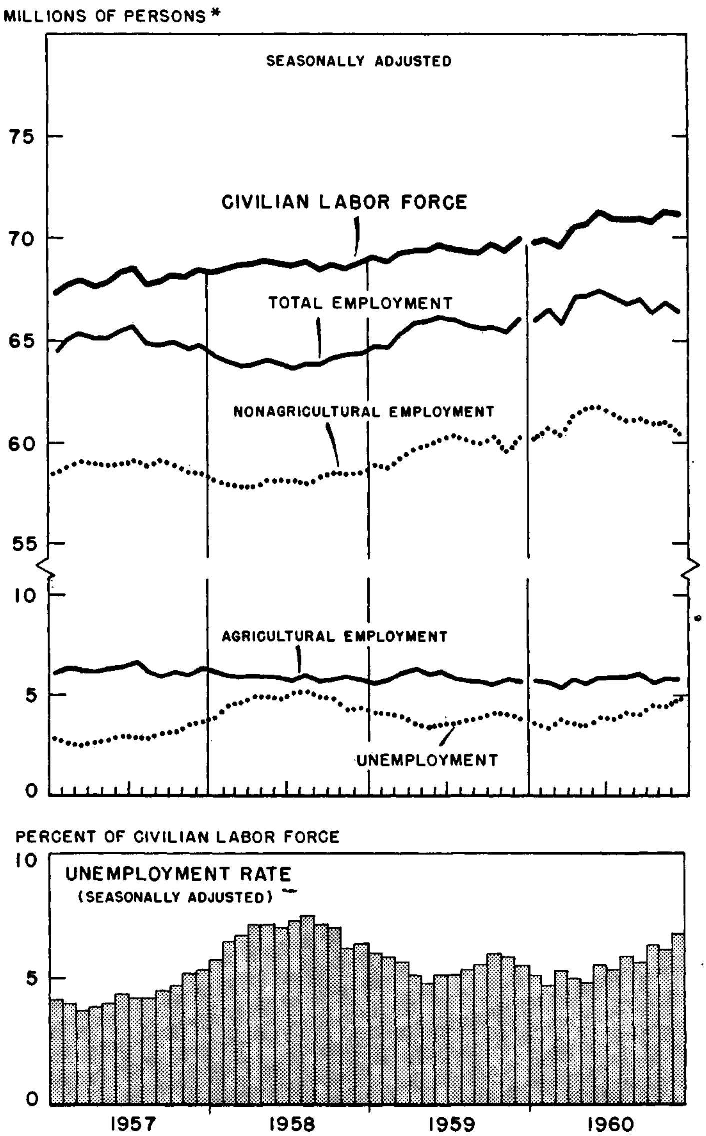
Employment and Unemployment

After the steel industry resumed operations in November 1959, total civilian employment expanded rapidly and by December had almost recovered to its pre-strike figure, seasonally adjusted, of 66.2 million (Chart 5). The expansion was largely in the employment of workers in durable goods producing industries; most of the increase in employment was reflected in a drop of unemployment, from 4.2 million in October 1959, when the strike was still in progress, to 3.8 million in December 1959. During the period of recovery from the strike, higher demand for labor also resulted in longer workweeks and increased overtime in durable goods industries.

CHART 5

Civilian Labor Force

The labor force expanded substantially in 1960. Employment declined and unemployment increased during the second half of the year.



* 14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF LABOR.

Civilian employment continued to expand with the increase in economic activity during the first half of 1960; by June, the seasonally adjusted figure was 67.4 million. Meanwhile, the civilian labor force also increased at about the same rate, so that the change in unemployment was minor.

For 1960 as a whole, employment averaged 66.7 million and the civilian labor force averaged 70.6 million. These were record numbers, representing gains above average 1959 levels, after allowance for the inclusion of Alaska and Hawaii.

Total payroll employment in nonagricultural establishments expanded moderately during the first half of the year and reached 53.4 million, seasonally adjusted, in June. Widely divergent trends appeared, however, in important industries. Total employment in manufacturing changed very little in the half year. Employment in durable goods industries decreased after February, as work forces were sharply reduced in industries producing primary metals and transportation equipment, but this decrease was largely offset by a moderate expansion in nondurable goods manufacturing. In nonmanufacturing industries, employment increased without significant interruption, especially in trade, finance, service, and government.

Total payroll employment began to decline in August as additional manufacturing industries curtailed work forces, the automobile industry shut down earlier than usual for its annual model changeover, and construction firms restricted operations. In most major industry groups except finance, services, and government, employment fell after midsummer (Chart 6). Declines in aggregate employment continued to the end of the year, with the declines being particularly marked in the final months. Through December 1960, the total reduction of payroll employment from the July peak amounted to about 951,000. Payroll employment in December 1960 totaled 52.5 million, compared with 52.9 million in December 1959.

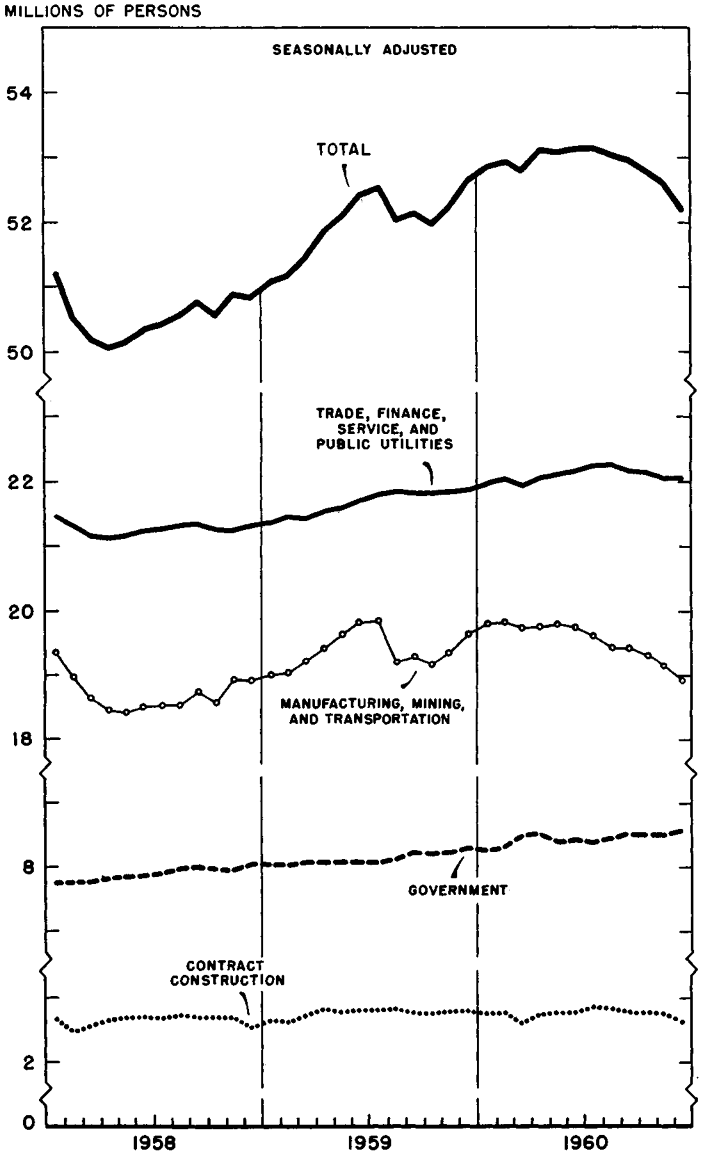
The average workweek of production workers in manufacturing industries declined from 40.4 hours in January to 39.6 hours in April, both seasonally adjusted (Chart 7). This contraction was due, in part, to temporary and noneconomic factors. After a recovery to 40.1 hours in May, the average again fell as increasing numbers of workers in manufacturing industries went on part-time schedules.

Unemployment, seasonally adjusted, declined to 3.5 million in May, but then rose over the remainder of the year, to 4.9 million, or 6.8 percent of the labor force, in December. Insured unemployment, which covers persons eligible to draw unemployment benefits, increased sharply, after seasonal adjustment, in the second half of the year.

CHART 6

Employment in Nonagricultural Establishments

Manufacturing, mining, and transportation accounted for nearly all of the decline in payroll employment after the middle of 1960.

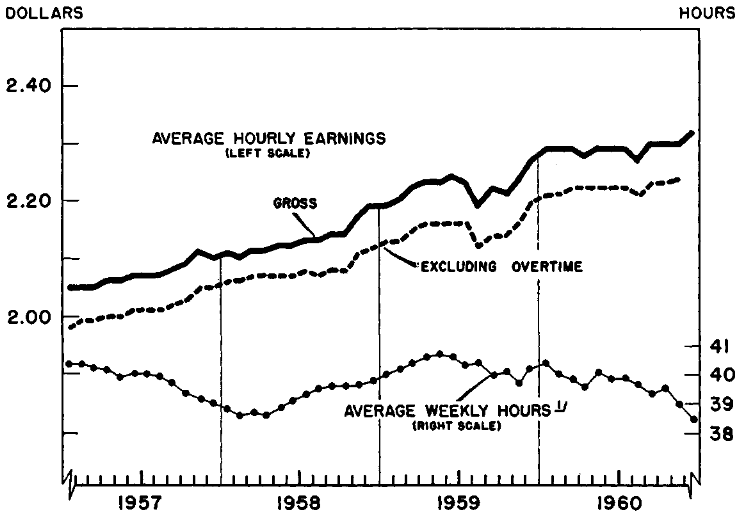


SOURCE: DEPARTMENT OF LABOR.

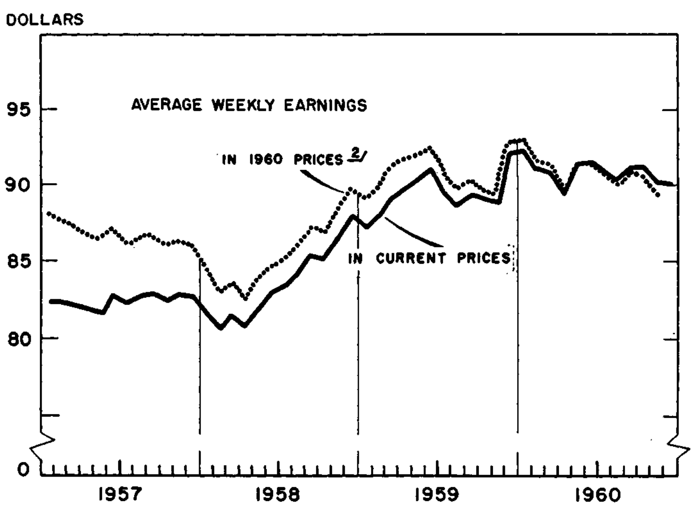
CHART 7

Hours and Earnings in Manufacturing

The workweek declined during 1960, but average hourly earnings increased slightly.



Average weekly earnings declined as the workweek was reduced.



1/ SEASONALLY ADJUSTED.

2/ CONSUMER PRICE INDEX USED AS DEFLATOR.

NOTE: DATA RELATE TO PRODUCTION WORKERS.

SOURCE: DEPARTMENT OF LABOR.

The turnover of the unemployed group remained high in 1960; during most months of the year, from two-fifths to one-half of the total number had been seeking work for less than 5 weeks. Nevertheless, long-term unemployment—the number of persons seeking work for 15 weeks or more—increased after May, and in December amounted to 1.2 million, after seasonal adjustment, compared with 1.0 million in December 1959. The unemployment rate for married men also increased during the second half of the year; for 1960 as a whole, however, it averaged 3.7 percent of their number in the labor force, about the same as in 1959.

The increase in unemployment was reflected in the Department of Labor's classification of the Nation's 147 major labor market areas according to adequacy of labor supply. In November 1960, 48 major areas were classified as having "substantial labor surpluses" (unemployment of 6 percent or more of the labor force), compared with 28 in January. A large proportion of total unemployment, and an even larger part of long-term unemployment, remains concentrated in the 19 major labor market areas having "substantial and persistent labor surpluses," most of which are located in the northeastern part of the country. In May 1960, before the downturn of total employment, the unemployment rate in these areas averaged 7.9 percent, compared with 4.7 percent for all the remaining areas.

Semiskilled, unskilled, and inexperienced workers were reported to be in surplus supply in nearly all sections of the country, but many labor market areas continued to report shortages of professional, technical, secretarial, clerical, and skilled workers.

Prices

Prices in different sectors of the economy followed divergent trends in 1960. The net result of these movements was an increase in the consumer price index of 1.4 percent and an unchanged level for the index of wholesale prices.

The increase in the consumer price index was about the same as during 1959 (Table 3). This outcome conceals, however, an important difference between the two years in the role of consumer goods prices, both of durables and nondurables, which in the past have contributed importantly to upward movements. Whereas in 1959 both of these sectors showed noticeable advances, in 1960 the prices of nondurable goods, excluding food, rose only very moderately, while those of durable goods declined. Food prices, on the other hand, which tend to move partly in response to special factors, increased in 1960, while they had fallen in 1959. Prices of services advanced, as they have done in earlier years (Chart 8).

Investment goods prices also reflected an easing of upward pressures. Prices of producer finished goods rose until September 1959, but thereafter

TABLE 3.—*Changes in consumer price index, 1959 and 1960*

Item	Relative importance December 1959 (percent) [1]	Percentage change	
		December 1958 to November 1959	December 1959 to November 1960
All items	100.0	1.5	1.5
Commodities	64.1	.8	1.0
Food	28.0	−.7	2.8
Food at home	23.2	−1.5	3.0
Commodities less food	36.1	1.8	−.4
Nondurable commodities	22.5	2.4	1.0
Apparel	8.9	1.7	1.4
Shoes [2]	1.4	7.4	.1
Durable commodities	13.6	1.1	−2.7
Cars, new	3.0	.5	−2.9
Cars, used	1.8	6.4	−14.2
Durables less cars	8.8	.2	−.5
Appliances [2 3]	3.1	.2	−1.1
Services	35.9	2.9	2.4
Rent	6.2	1.3	1.3
All services less rent	29.7	3.1	2.6

[1] Weights do not add to 100 because the miscellaneous category, not actually priced but imputed, is omitted.
[2] Comparisons are for December 1958 to December 1959 and December 1959 to September 1960.
[3] Includes household appliances, radios, and television sets.

Source: Department of Labor.

fluctuated within a narrow range. Since the turn of 1960, construction costs have shown a similar stability.

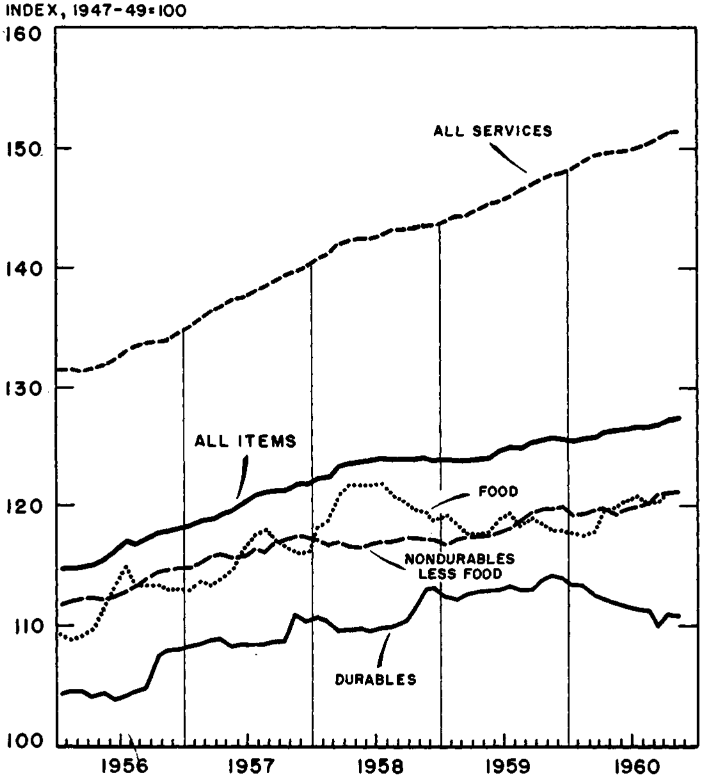
Wholesale prices in general have remained steady since early 1958 (Chart 9). In the earlier part of the period, there was a moderate increase in industrial prices, but this was offset by lower prices of farm products and processed foods. The reverse was true in 1960, as prices of farm products and processed foods rose noticeably and industrial prices drifted down a little. However, prices of certain basic items, such as metals and their products, electrical machinery, and especially lumber, declined more markedly. Prices of crude industrial materials as a group fell considerably; but at intermediate stages of processing, declines in industrial prices have not been large.

The weakening in the upward tendency of prices reflected the combined impact of several factors. Monetary and fiscal policies served to avoid speculative excesses and pressures of demand upon capacity and helped to create attitudes on the part of businessmen and consumers favorable to price stability. As 1960 progressed, evidence of ample supplies and the slackening of the economic advance strengthened these attitudes and gave rise to keener competition as well as more careful buying habits. Wage increases of only moderate amount likewise contributed to greater price stability. Average hourly earnings of production workers in manufacturing, adjusted for interindustry shifts, which had advanced by more than 5 percent in 1956 and 1957, gained only 3.4 percent in 1959 and about the same amount in the past year. However, such increases in manufacturing and industries other than agriculture, viewed as part of the long-term trend in hourly wage rates, are still somewhat greater than the average annual improvement in productivity in the past decade.

CHART 8

Consumer Prices

The 1960 rise in consumer prices was due largely to an advance in food prices and to the continuing increase in prices of services. Prices of durable goods fell markedly.

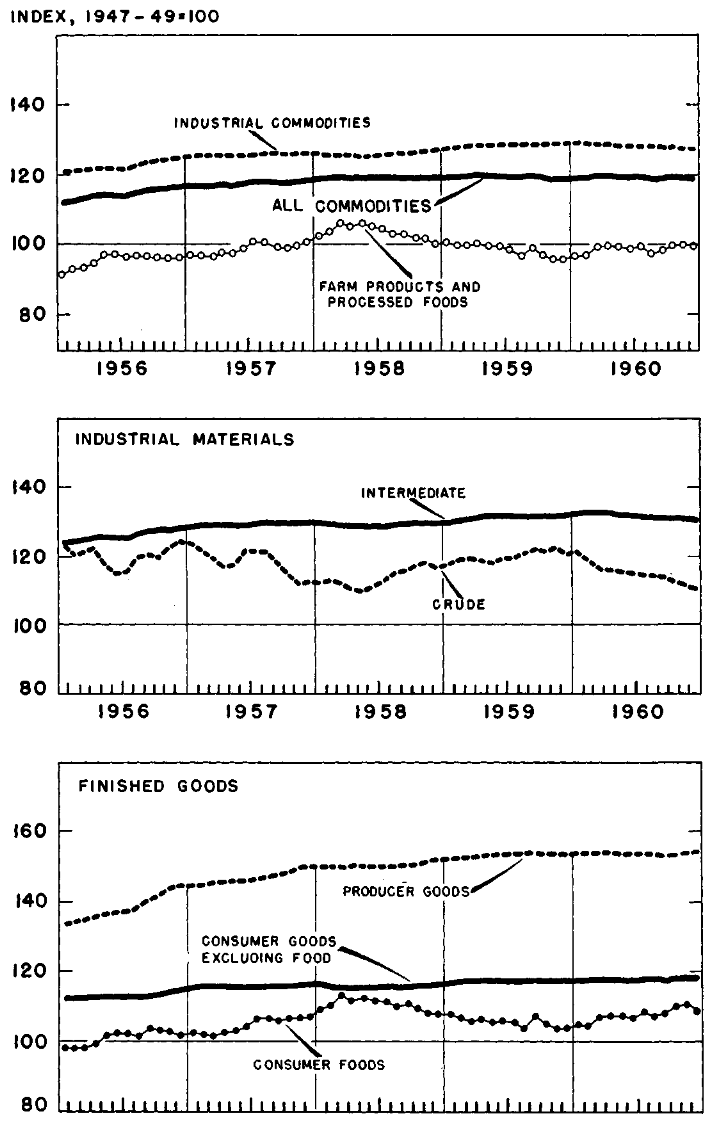


SOURCE: DEPARTMENT OF LABOR.

CHART 9

Wholesale Prices

The over-all wholesale price index continued steady in 1960, but prices of crude industrial materials declined substantially.



SOURCE: DEPARTMENT OF LABOR.

Agricultural output in 1960 reached a record high for the third year in succession. Output, especially of field crops, was stimulated by incentive price supports for several commodities, the more extensive use of fertilizers, and favorable weather. Production of corn and grain sorghums set new records, and output of wheat and soybeans was exceeded only in 1958. Total livestock production decreased slightly, as hog, poultry, and egg production declined early in the year in response to unsatisfactory prices prevailing toward the end of 1959, and cattle production continued the expansion phase of its typically long cycle.

Prices and incomes received by farmers, which had declined in late 1959, improved by mid-1960 with better market conditions. Later, substantial advances by the Commodity Credit Corporation (CCC) on loans on wheat, corn, and other price-supported crops from the 1960 harvests helped to sustain income. Gross income of farm operators, estimated at $37.9 billion, was $400 million larger than the 1959 income. Farm production expenses changed very little, as lower costs for expense items originating in the farm sector, notably feed and feeder livestock, all but offset the higher costs of certain other production goods and services. Tax and interest costs were substantially greater than in 1959. Farm wage rates were somewhat above those in 1959, but fewer workers were employed.

With their gross income slightly higher and production expenses nearly the same as in 1959, farm operators' net income from farming in 1960 was a little greater than in 1959 (Chart 10). Realized net income, which excludes inventory change, rose from $11.3 billion in 1959 to an estimated $11.6 billion in 1960. Whether reported exclusive or inclusive of inventory change, net income in 1960 was about the same as the average for the five preceding years; but, since the number of farms has decreased steadily, net income per farm in 1960 was about 5 percent higher than the 1955–59 average.

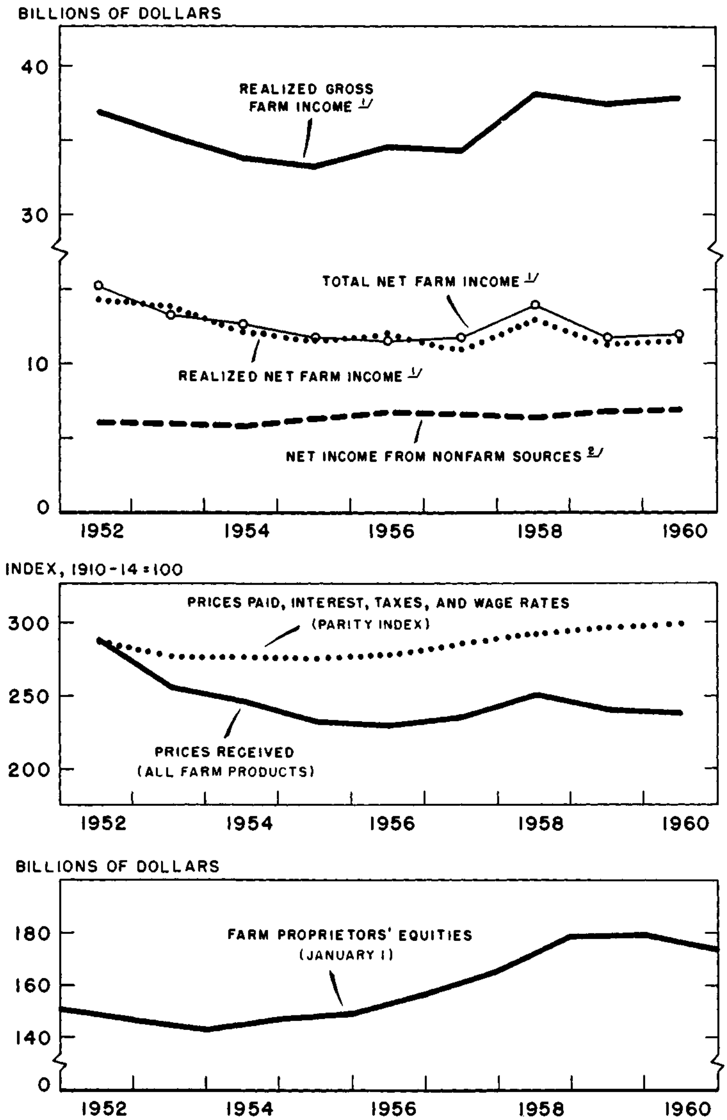
Hired farm workers living on farms received about $1.8 billion in farm wages. Income of all farm people from nonfarm sources, including in particular wages earned from part-time work off the farm, was a little larger in 1960 than in 1959, rising to a record $6.9 billion.

Market values of farm real estate leveled off and then receded a little during 1960 after an almost uninterrupted upward trend that started before World War II. There were moderate declines in the Corn Belt and Northern Plains, and further small increases occurred in most of the Southern, Mountain, and Pacific States. Total farm assets at the end of 1960 amounted to $199.3 billion, 2 percent less than a year earlier. Farm indebtedness continued to increase. By the end of the year, indebtedness reached $25.7 billion, or 13 percent of assets, leaving an equity in farm investment of $173.6 billion, 3 percent less than the equity 12 months earlier.

CHART 10

Indicators of Agricultural Conditions

Incomes of farmers, from farm and nonfarm sources, rose slightly in 1960. Farm proprietors' equities declined.



1/ INCOME OF FARM OPERATORS, INCLUDING GOVERNMENT PAYMENTS

2/ INCOME OF ALL FARM PEOPLE.

SOURCE: DEPARTMENT OF AGRICULTURE.

An outstanding feature of agricultural developments in 1960 was the strong expansion of exports of farm products. The volume of these exports reached a new high in the fiscal year 1960, and their value, at $4.5 billion, was second only to the record $4.7 billion attained in the fiscal year 1958. Since the major export crops are given Government price support, the large exports, which are partly subsidized, served chiefly to ease the financial burden on the Commodity Credit Corporation; however, they also helped to sustain farm income.

Despite extensive efforts in food distribution and other surplus removal activities, 1.8 billion bushels of corn, 1.5 billion bushels of wheat, 5.3 million bales of cotton, and substantial quantities of several other products remained in CCC inventory or under CCC loan at the end of 1960. Accumulated investment of the Corporation in price-supported commodities amounted to $9.1 billion.

Monetary and Fiscal Areas

Early in 1960, inflationary forces were being brought under control. Efforts to bring the budget into balance were meeting with success, and the emerging surplus, augmented by seasonal factors, permitted some debt retirement. Under these circumstances, the Federal Reserve authorities moved to reduce monetary restraint.

As the year proceeded, developments increasingly called for an extension of this policy, and the Federal Reserve accordingly took a variety of steps toward more positive promotion of monetary ease. At the same time, pressure upon corporate profits reduced prospective tax revenues from this source. The budget surplus for the fiscal year 1961, which had been estimated at $4.2 billion in January, was revised to $1.1 billion in the fall; an approximate balance is now estimated. The restraining effect of the budget on the economy diminished in this period. In view of the decline in residential construction, Federal housing programs were adjusted to provide additional stimulus. Advantage was taken of the possibility of accelerating the Federal highway program, as well as some other Federal programs.

Monetary and Credit Policy

As the year began, interest rates on Treasury bills were just reaching a peak, although net borrowed reserves had passed their high point in early August 1959. The money supply (demand deposits and currency, seasonally adjusted) had been declining since July 1959.

Demand for most forms of bank credit, however, began to slacken early in 1960. Business loans, which reflected the strong pace of inventory accumulation, were the major exception in this downturn. With the demands of the Federal Government on the financial markets also reduced, interest rates eased rapidly during the early months of the year. Total

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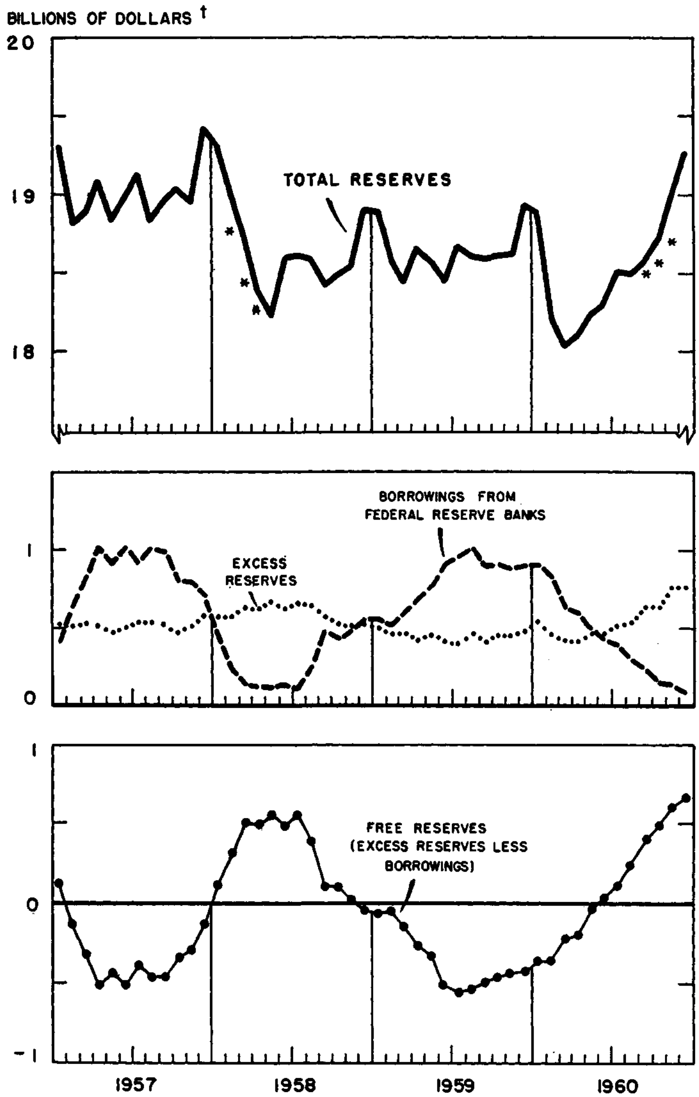
CHART 11

Member Bank Reserves and Borrowings

Pressures on bank reserves eased during 1960. Beginning in the spring, total reserves rose.



† AVERAGES OF DAILY FIGURES.
* RESERVE REQUIREMENTS CHANGED.
NOTE: BEGINNING DECEMBER 1959, RESERVES INCLUDE VAULT CASH ALLOWED.
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

loans and investments of commercial banks, as well as total bank reserves and the money supply, fell more than they normally do early in a year.

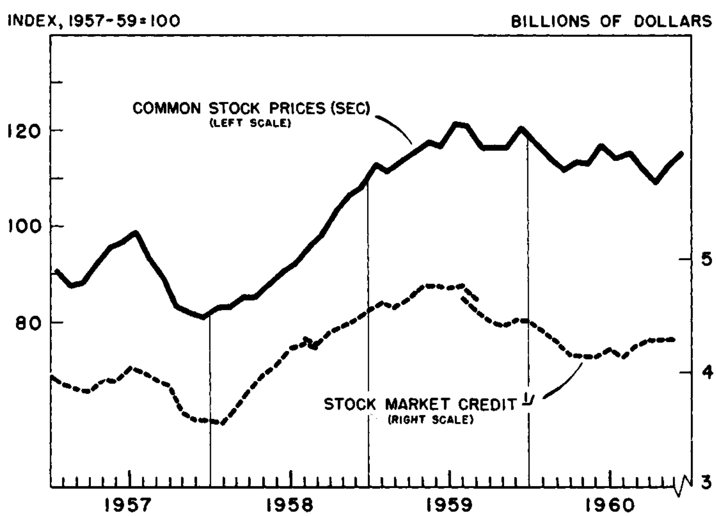
Through April, Federal Reserve open market operations had the effect of easing the position of the banks, although not on a scale sufficient to prevent a more than usual shrinkage in total reserves. By late spring, net borrowed reserves of banks approached zero (Chart 11) and the rate on three-month Treasury bills dropped below 3 percent. The demand for business loans meanwhile fell short of its increase in most recent years, as the rate of inventory accumulation diminished. The demand for other loans also reflected some slackening in economic activity. These developments were further highlighted by a general decline in stock prices (Chart 12). Thus, further monetary easing was clearly called for, and, accordingly, open market operations became more aggressive. Beginning in May, growing monetary ease was reflected in a greater than usual rise in total reserves of banks, and after midyear the downward trend in the money supply was reversed.

In June, the Federal Reserve Banks reduced discount rates from 4 percent to 3½ percent, and in August and early September rates were cut again,

CHART 12

Stock Prices and Stock Market Credit

Stock prices declined during much of 1960, but rose late in the year, as did stock market credit.



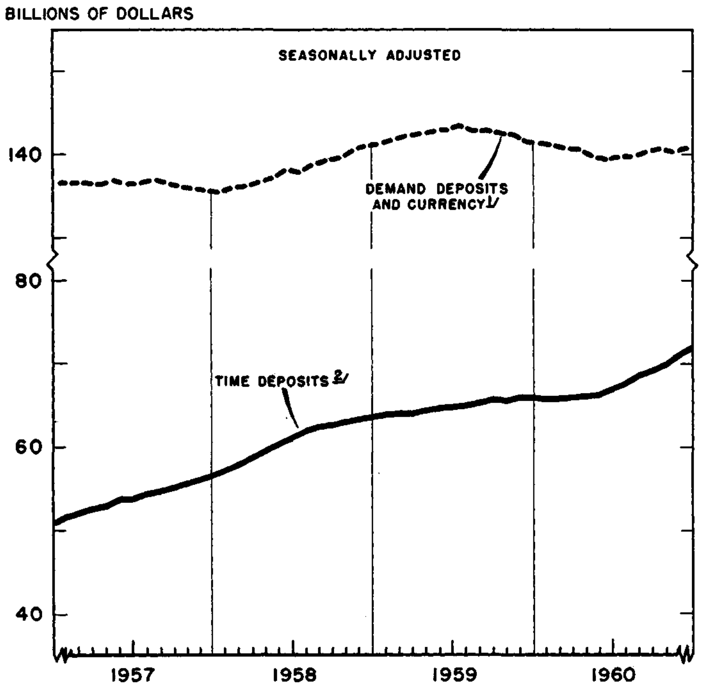
1/ CUSTOMERS' NET DEBIT BALANCES AND BANK LOANS TO OTHERS THAN BROKERS AND DEALERS; END OF MONTH.

SOURCES: VARIOUS GOVERNMENT AND PRIVATE AGENCIES.

CHART 13

Money Supply

After mid-1960, demand deposits and currency rose somewhat and time deposits expanded rapidly.



1/ DEMAND DEPOSITS AT ALL COMMERCIAL BANKS AND CURRENCY OUTSIDE BANKS; AVERAGES OF DAILY FIGURES.

2/ TIME DEPOSITS AT ALL COMMERCIAL BANKS; END OF MONTH.

SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

to 3 percent. In two successive steps taken in September and December, reserve requirements against demand deposits for central reserve city banks were reduced from 18 percent to 16½ percent. Most important, from the point of view of providing reserves, all vault cash was made available for meeting reserve requirements. As a partial offset, requirements for country banks were raised from 11 percent to 12 percent.

As the year progressed, the expansion of loans continued to be moderate. Funds supplied through Federal Reserve actions were used by banks primarily to purchase United States Government securities; such purchases from June through December amounted to $7.1 billion. The expansion in bank loans and investments produced only a small rise in the money supply, because the resultant deposits predominantly took the form of time deposits.

Beginning in late October, Federal Reserve purchases of United States Government securities were extended to short-term securities other than Treasury bills for the first time since 1958. The action was considered appropriate in the light of the outflow of capital, stimulated in part by the sharply lower yield on short-term United States securities in comparison with the rate on equivalent securities in other countries.

For 1960 as a whole, the money supply decreased by $1.0 billion, against a rise of $600 million in 1959. Time deposits, however, increased much more than in 1959, the gain amounting to about $5.9 billion (Chart 13). Bank credit rose by $8.4 billion, moderately more than in 1959. But loans rose by only $5.8 billion, against an increase of $11.9 billion in the preceding year. The slower pace of bank lending, despite the larger volume of funds available, was due to the lessened demand for total credit by all major sectors of the economy. Banks, therefore, were able to add about $2.4 billion to their holdings of United States Government securities, thus reversing the heavy liquidation of such securities that had taken place in 1959 (Table 4).

TABLE 4.—*Net changes in commercial bank holdings of loans and investments, 1955–60*

[Billions of dollars]

Loans and investments	1955	1956	1957	1958	1959 [1]	1960 [2]
Loans (excluding interbank) and investments [3]	4.6	4.2	4.9	15.1	4.0	8.4
Loans (excluding interbank) [3]	11.6	7.6	3.5	4.3	11.9	5.8
Business	6.4	5.5	1.8	−.1	[4] 5.1	[5] 2.2
Real estate	2.4	1.7	.6	2.1	2.5	.7
Consumer	2.3	1.4	1.2	.2	2.8	1.4
Security	.6	−.8	−.1	.4	.2	.2
Agricultural	−.7	−.3	−.1	.9	(6)	.7
Nonbank financial institutions	(7)	(7)	(7)	(7)	(7)	−.1
All other	.9	.4	.3	1.0	[4] 1.5	[5] .6
Investments	−7.0	−3.5	1.3	10.8	−7.9	2.7
U.S. Government securities	−7.4	−3.0	−.3	8.1	−7.7	2.4
Other securities	.4	−.4	1.7	2.6	−.2	.3

[1] Structural changes in 1959 are excluded. On balance through August, these changes added almost $1 billion in total credit; $600 million in loans; $300 million in U.S. Government securities; and $100 million in other securities. Real estate loans increased about $300 million; business loans, $100 million; consumer loans, $100 million; and other loans $100 million.
[2] Preliminary estimates by Council of Economic Advisers.
[3] Total loans are net of, and individual loans are gross of, valuation reserves.
[4] Includes estimate of loans to nonbank financial institutions on December 31, 1959.
[5] Excludes loans to nonbank financial institutions, shown separately, and is not strictly comparable with previous data.
[6] Less than $50 million.
[7] Reported in business and "all other" loans prior to June 10, 1959, and estimated in business and "all other" loans on December 31, 1959.

NOTE.—Changes are based on amounts outstanding at end of year.
See Table C–41 for totals including interbank loans.
Detail will not necessarily add to totals because of rounding.

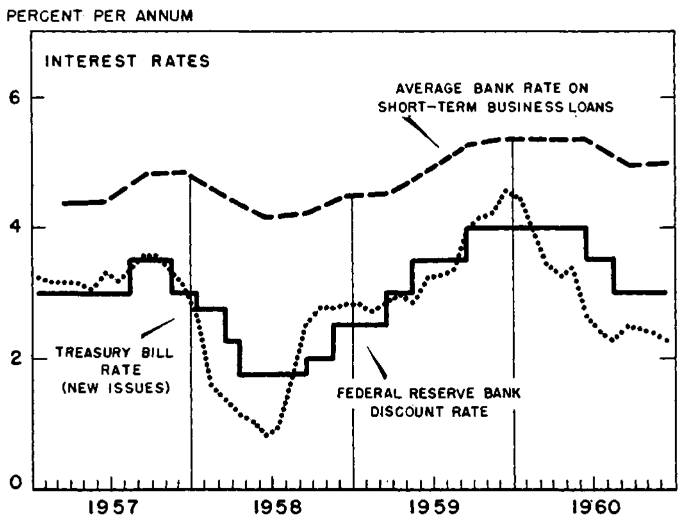
Source: Board of Governors of the Federal Reserve System (except as noted).

With both an easier monetary policy and reduced demands for credit, interest rates declined over the year. For United States Government bonds and municipal bonds, the declines were relatively substantial; they were less so for commercial bank loans and corporate bonds. Rates on mortgage loans declined very little (Chart 14).

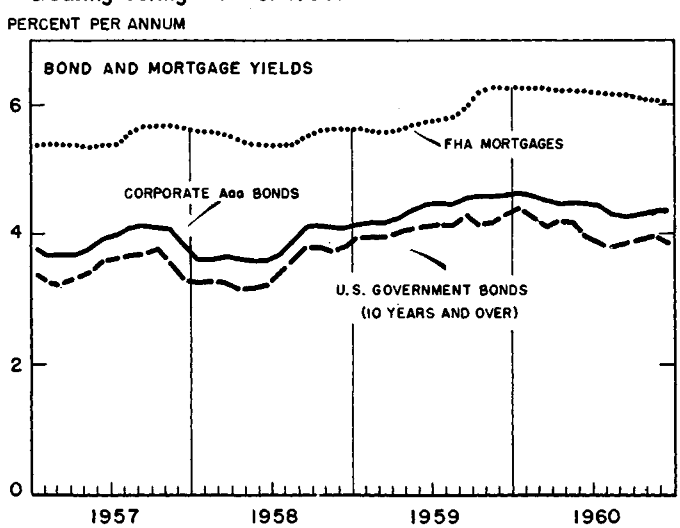
CHART 14

Interest Rates and Bond and Mortgage Yields

Short-term interest rates fell in 1960 after having risen sharply during 1959.



Long-term interest rates also declined during 1960 after increasing during most of 1959.



SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TREASURY DEPARTMENT, FEDERAL HOUSING ADMINISTRATION, AND MOODY'S INVESTORS SERVICE.

Total liquid assets, including the money supply, which had expanded at a relatively slow pace in late 1959, changed very little during the first half of 1960, if account is taken of seasonal factors. There was a decline in the money supply and some reduction in marketable United States Government securities maturing within one year. As the year progressed, however, purchases of consumer goods lagged, and personal type savings, such as time deposits and savings and loan shares, began to expand rapidly. Demand for these types of assets appears to have been stimulated also by more favorable returns available on them relative to those on marketable securities. As a result, total liquid assets expanded in the latter part of the year (Table 5).

TABLE 5.—*Changes in selected liquid assets held by the public, 1957–60*

[Billions of dollars]

Asset class	1957	1958	1959	1960 [1]
Money supply (demand deposits and currency outside banks)	−0.9	5.5	0.6	−1.0
Personal type savings	8.5	14.2	7.2	13.9
Time deposits at commercial banks	5.5	7.1	2.4	5.9
Deposits at mutual saving banks	1.4	2.1	.8	1.3
Savings and loan shares	4.8	6.1	6.6	7.4
U.S. Government savings bonds	−3.2	−1.1	−2.6	−.7
U.S. Government securities maturing within one year	4.2	−1.7	10.8	−5.3

[1] Preliminary estimates by Council of Economic Advisers.

NOTE.—Changes are based on amounts outstanding at end of year except changes in money supply, which are based on daily averages for December.

Sources: Board of Governors of the Federal Reserve System and Treasury Department (except as noted)

The response of the financial mechanism during 1960 to Federal Reserve policies was generally typical of a period in which a policy of restraint gives way to one of ease. The easing was first reflected in reduced net borrowed reserves and sharp declines in short-term interest rates, and only later in the expansion of total bank reserves, bank credit, and deposits. Commercial banks were inclined to reduce their high indebtedness to the Federal Reserve System before employing available reserve funds to expand credit further. The low return on Treasury bills in relation to the discount rate prevailing during the late winter and spring, as well as subsequently during the year, probably influenced banks in these decisions. The response of bank credit was also affected by the tendency for an especially large amount of excess reserves to be concentrated during the late summer and fall in country banks while other banks remained under pressure. Since country banks employ their surplus funds less actively, this factor may have impeded a more rapid response of total bank credit and the money supply to Federal Reserve action. The expansion of the money supply in turn tended to lag behind credit expansion because the latter reflected primarily an increase in time deposits.

A somewhat analogous development was observable with respect to the major types of savings institutions, including life insurance companies, savings and loan associations, and mutual savings banks. The larger flow of funds generally available to these institutions led to only a very gradual decline in interest rates on mortgages, and the yield on corporate bonds also was slow in being reduced. The behavior of lenders of long-term funds appeared to reflect the experience of earlier periods of declining interest rates, which were quickly followed by a return to higher levels.

Fiscal and Debt Management Policies

Fiscal policy during 1960 was oriented toward maintaining over-all stability in the economy in conjunction with the more flexible operations of the monetary authorities. For the fiscal year 1960, the Federal budget attained a surplus of $1.2 billion. It is presently expected that the budget for the fiscal year 1961 will show a very close balance (Chart 15). The improvement in the budgetary outcome for 1960, following a deficit of $12.4 billion in the preceding fiscal year, reflected increasing revenues as a result of the expansion of the economy and, to a lesser extent, a reduction in Federal expenditures.

Expenditures in the fiscal year 1960 were $3.8 billion lower than expenditures in the fiscal year 1959 (Table 6), while budget receipts rose by $9.9

TABLE 6.—*Federal budget expenditures, 1959–62*

[Fiscal years, billions of dollars]

Function	1959	1960	1961 (estimated)	1962 (estimated)
Total budget expenditures	80.3	76.5	78.9	80.9
Major national security	46.4	45.6	45.9	47.4
International affairs and finance	3.8	1.8	2.3	2.7
Commerce, housing, and space technology	3.4	2.8	3.8	3.4
Agriculture and agricultural resources	6.5	4.8	4.9	5.1
Natural resources	1.7	1.7	2.0	2.1
Labor and welfare	4.4	4.4	4.5	4.8
Veterans services and benefits	5.2	5.1	5.2	5.3
Interest	7.7	9.3	9.0	8.6
General government	1.6	1.7	2.0	2.1
Allowance for contingencies				.1
Deduct: Interfund transactions	.4	.7	.7	.7

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

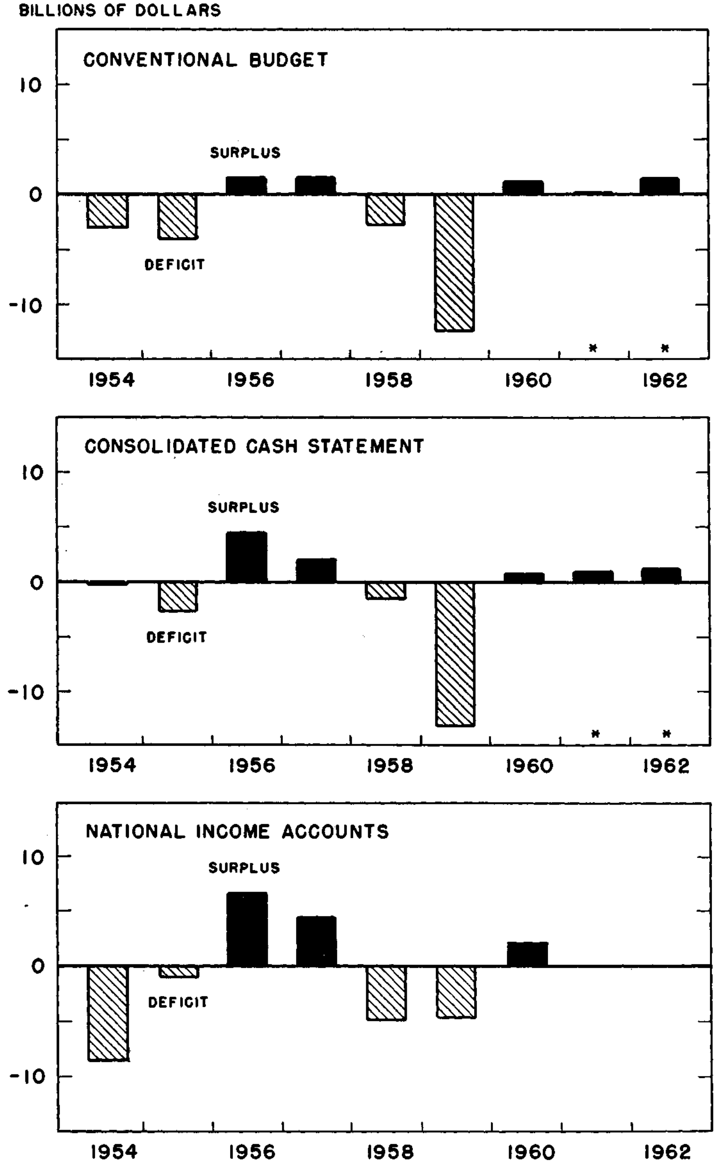
Sources: Treasury Department and Bureau of the Budget.

billion. The reduction in total expenditures was made possible in part by the termination of certain expenditures incurred for antirecession purposes in the previous year, as well as of some nonrecurring expenditures. Expenditures were lower for housing, owing to the termination of the special mortgage purchase program of the Federal National Mortgage Association authorized in 1958, and for international affairs and finance, because the 1959 expenditures had included nonrecurrent increases in the United States subscription to the International Monetary Fund. Farm income support expenditures also declined considerably in

CHART 15

Surplus or Deficit of the Federal Government

The Federal budget is expected to be in balance for fiscal year 1961 and to show a surplus in fiscal year 1962.



* ESTIMATE.

SOURCES: TREASURY DEPARTMENT, BUREAU OF THE BUDGET, AND DEPARTMENT OF COMMERCE.

the fiscal year 1960. The advances to States for financing the temporary extension of unemployment benefits were discontinued, and expenditures for military assistance diminished. On the other hand, there were increases in some expenditures, particularly those related to natural resources development, research, and space exploration. Interest payments on the public debt increased sharply as rates advanced during the first half of the fiscal year.

The sharp increase in Federal receipts in the fiscal year 1960 reflected the strong sensitivity of Federal revenues to fluctuations in the economy. Of the total increase, corporate income tax receipts accounted for $4.2 billion and individual income taxes for $4.0 billion (Table 7).

TABLE 7.—*Federal budget receipts, 1959–62*

[Fiscal years, billions of dollars]

Source	1959	1960	1961 (estimated)	1962 (estimated)
Total budget receipts	67.9	77.8	79.0	82.3
Individual income taxes	36.7	40.7	43.3	45.5
Corporation income taxes	17.3	21.5	20.4	20.9
Excise taxes	8.5	9.1	9.3	9.7
Employment taxes	.3	.3		
Estate and gift taxes	1.3	1.6	1.9	2.0
Customs	.9	1.1	1.1	1.1
Miscellaneous receipts	3.2	4.1	3.7	3.8
Deduct: Interfund transactions	.4	.7	.7	.7

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

Sources: Treasury Department and Bureau of the Budget.

For the fiscal year 1961, budget expenditures are estimated as $2.4 billion higher than in the preceding fiscal year. Outlays for all major functions except interest payments on the public debt are expected to rise. The increases are attributable in varying degree to new legislation, primarily the pay raise to Federal civilian employees; to increases in relatively uncontrollable expenditures, such as grants to States for public assistance and payments for veterans' compensation, pensions, and medical care; to past commitments for such purposes as water resources projects, space exploration, and civilian aviation; and to higher Congressional appropriations for defense and other programs.

The increase in revenues in fiscal 1961 is now estimated at $1.2 billion, substantially less than the expected increase in expenditures. Most of this rise is due to an increase, estimated at $2.6 billion, in receipts from individual income taxes, reflecting higher personal incomes. Corporate tax receipts, however, are expected to decline. Receipts from excise taxes will probably increase, but a decline in all other receipts is foreseen, partly because of the transfer of Federal unemployment tax receipts from general revenues to the unemployment trust fund, in accordance with the Social Security Act Amendments of 1960.

A number of tax revenue measures were recommended by the President last January and acted upon by the Congress. Both the corporation income tax rates and certain excise tax rates scheduled for reduction or repeal on July 1, 1960 were extended for one year. The Congress also enacted legislation that had been recommended in order to prevent unintended and excessive deductions in the computation of depletion allowances on certain mineral products. On the other hand, the Congress again failed to take action on a number of revenue recommendations, but enacted certain unrecommended measures that will reduce 1961 revenues by at least $100 million.

The change in the Federal budgetary picture between the fiscal years 1959 and 1960 is even more striking if the transactions are considered on a consolidated cash basis, which includes the trust funds. Following a consolidated cash deficit of $13.1 billion in the fiscal year 1959, there was a cash surplus of $800 million in the fiscal year 1960. A cash surplus of $1.1 billion is expected in fiscal 1961.

The effect upon economic conditions of changes in the financial position of the Federal Government during the fiscal year 1960 becomes clearer when stated in terms of the national income accounts, which reflect tax liabilities as they are incurred and present the Government's activities in terms more directly related to the over-all level of economic activity. In these terms, there was a surplus of $5.2 billion (seasonally adjusted) in the second half of the fiscal year 1960. In recent months, however, the surplus has been considerably reduced. The restraining effect of the budget on the economy thus was substantially lessened in the course of 1960.

At the State and local level, receipts during fiscal 1960 continued their advance, which over the past decade has proceeded at a faster rate than the gain in Federal revenues. State tax collections increased by $2.2 billion, more than twice their growth in 1959. This reflected both the strength in underlying economic conditions and a number of legislative changes in the base, rate, or collection-timing of particular major taxes. These enactments were exceptionally numerous in 1959 and became effective mainly in fiscal 1960.

State and local expenditures also continued to rise during the fiscal year 1960, and somewhat more than receipts. The increase was mostly in payrolls. Expenditures for new construction remained fairly stable for the fiscal year as a whole, but they have been increasing recently. Long-term borrowing by State and local governments during the first half of the calendar year 1960 was about 10 percent less than in the corresponding period of 1959, but the pace quickened in the third quarter.

For the calendar year 1960, the surplus in the Federal budget permitted a reduction of $425 million in the public debt, in contrast to the rise of $7.9 billion in 1959. This, along with the easing in credit markets, facilitated the Treasury's management of the public debt. The Treasury's ability to lengthen the average maturity of the outstanding debt was still limited, however—especially in the first half of the year—by the legal 4¼ percent interest ceiling on securities of more than 5 years' maturity.

The Treasury continued to develop new techniques of debt management in order to improve the marketing of United States Government securities and to contribute toward achievement of the broader goals of economic growth and stability. A considerable amount of short-term borrowing was put on a regular basis, thus minimizing the impact of refunding short-term issues on the credit markets. The Treasury also used, for the first time, the provisions of a law passed in September 1959 that makes possible the exchange of securities under advance refunding without the immediate recognition of any gain or loss for Federal income tax purposes. The use of this provision, a major improvement in debt management, lessens the market impact of long-term debt offerings and provides an incentive for present owners of United States securities to retain them. As a result in part of advance refunding, the average maturity, which had been 4 years and 4 months in December 1959, was extended to 4 years and 7 months in December 1960.

Federal Housing and Home Financing and Aid for Highways

Further policy actions bearing on the level of economic activity were taken in the areas of housing and highways. Residential construction, which had started to decline in the final quarter of 1959, was aided by several administrative measures in 1960. In February, the Federal Housing Administration (FHA) announced new procedures designed to facilitate the sale of existing houses traded in on the purchase of new homes; in April, the downpayments required on FHA-insured home loans were reduced to the minimum permitted by law; and in July, the purchase of FHA-insured loans by the general public was authorized under new procedures. The Veterans Administration increased by more than $100 million the amount of direct home loans made to veterans in rural areas and small communities during 1960; in July, legislation was enacted continuing for two years both the eligibility of World War II veterans to obtain guaranteed home loans and the availability of direct home loans.

The Federal National Mortgage Association (FNMA) raised the prices paid for loans purchased through its secondary market operations as the availability of mortgage funds in private markets improved. Two price increases of ½ point were announced, the first in July and the second in August. The maximum size loan per dwelling eligible for purchase under the secondary market program was raised by FNMA from $15,000 to $20,000 in January; and in October the issuance of stand-by commitments for the purchase of existing houses was authorized.

Interest rates charged by the Federal Home Loan Banks on advances to member institutions were lowered during the year. The latter generally took advantage of an increase in share deposits to reduce their outstanding advances from the Federal Home Loan Banks coincident with a slackening in the demand for mortgage credit. In the context of the college housing program, priority was given to loan applications for construction that could be commenced quickly. Administrative procedures were inaugurated in connection with urban renewal activities to aid localities in expediting the planning, execution, and completion of their projects.

After being relatively low in the early months of 1960, highway construction was increased in the second half of the year, as higher revenues resulting from the one cent per gallon increase in the tax on motor fuels made possible, first, the avoidance of a deficit in the Highway Trust Fund in consequence of legislation passed in 1958, and, thereafter, the apportionment to the States of the full amounts permitted by legislation and the more rapid obligation by the States of the apportioned funds.

Earlier-than-usual enactment of enabling legislation made possible an acceleration of procurement contract awards, and steps were taken to start at once Federal construction projects for which funds were made available at a relatively early date.

International Economic Developments

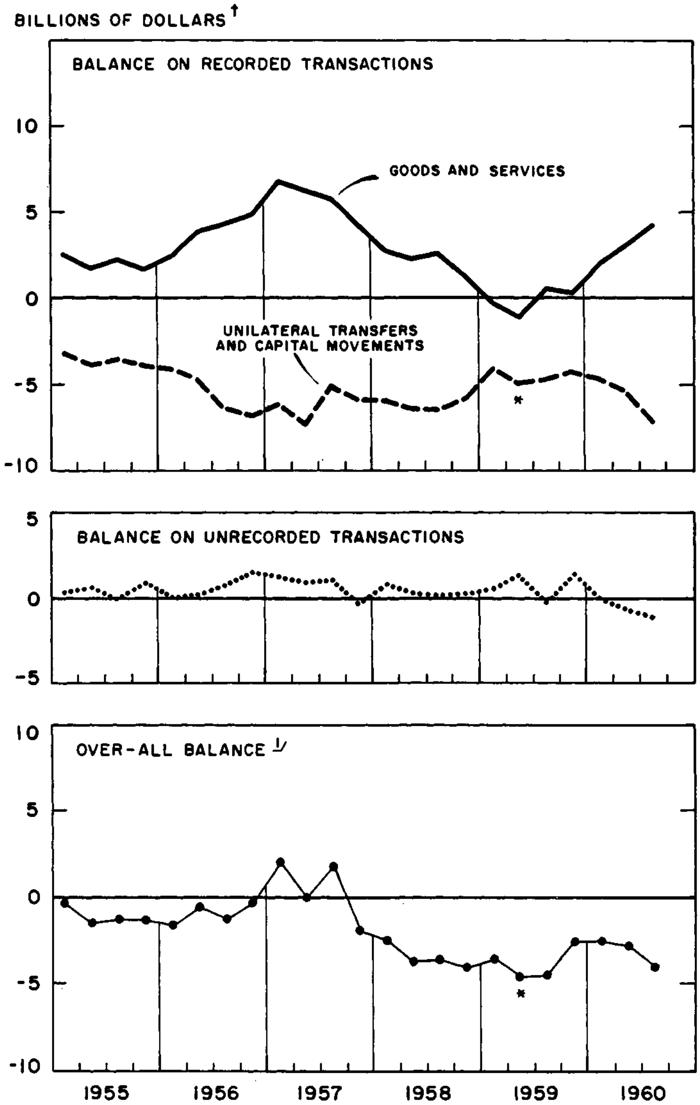
The over-all deficit in the United States balance of payments in 1960 remained close to that in each of the two preceding years. The structure of the deficit, however, changed markedly (Chart 16). Short-term capital outflows accelerated, mainly in response to the widening of the margin by which interest rates abroad exceeded those in this country. The deficit on all other transactions, on the other hand, diminished greatly, as a result of a rapid rise in exports. In the first half of the year, the over-all payments deficit was relatively low; it became sharply higher in the third quarter; and in the last quarter it appears to have declined again (omitting one large transfer of private direct investment capital), as the surplus on goods and services increased further and outflows of liquid capital seem to have decreased. The decline in the United States gold stock, which had slowed down in the first half of the year, accelerated in the second half, along with the increase in the over-all payments deficit.

The year's improvement in the balance on transactions other than movements of liquid capital was, in part, the result of high economic activity in Western Europe and Japan, which stimulated exports, and of the slackening of activity in the United States, which tended to limit imports. This divergence of economic conditions likewise accounted for the enlarged differential between the relatively high interest rates abroad and the relatively low rates in the United States, which led to outflows of liquid funds. The achievement of a reasonable equilibrium in United States international transactions on the average over a period of years continued to be a goal of this country's policies, domestic and international, in 1960.

CHART 16

U. S. Balance of Payments

The surplus on goods and services increased sharply in 1960, but the over-all payments deficit remained large as recorded and unrecorded capital outflows rose.



† SEASONALLY ADJUSTED ANNUAL RATES.

* EXCLUDES $1,375 MILLION INCREASE IN IMF SUBSCRIPTION.

1/ CHANGE IN U.S. GOLD HOLDINGS AND RECORDED LIQUID LIABILITIES.

SOURCE: DEPARTMENT OF COMMERCE.

Economic Expansion Abroad

The United States balance of payments in 1960 was heavily influenced by developments abroad. As foreign barriers to international transactions have been reduced and as Western Europe and Japan have regained their earlier positions in the world economy, the links among the major economies of the free world have become much closer than in earlier years.

The boom that got under way abroad in 1959 continued in varying degree during 1960 in most industrial countries outside North America. However, during the year some slowing down was noticeable—in a number of countries because of capacity limitations—and scattered soft spots appeared. Some countries on the European Continent which continued to experience boom conditions nevertheless had sizable export surpluses that were not offset by long-term capital outflows. Economic activity in Canada, which is the largest individual market for United States exports and which had been one of the first industrial countries to recover from the 1957–58 recession, turned down after the first of the year.

Economic policies in Western Europe and Japan were in general directed toward restraining excess demand throughout 1960; exceptions were France and Italy, where mild expansionary measures (including a reduction in the discount rate in France) were instituted in the second half of the year. Restraint was exerted mainly through monetary and credit policies, and interest rates rose in a number of countries; there were particularly sharp increases in short-term rates in the United Kingdom up to August and in Germany until October. In continental Europe, the authorities of several countries were faced with the problem of dealing with inflows of funds from abroad, which helped to enlarge bank liquidity. Special restrictions on such inflows were introduced during the summer in Germany and in Switzerland (which had attracted funds despite its relatively low interest rates). In November, the German central bank reduced its discount rate in a further effort to stem the inflow. Discount rates were also reduced in Japan (in August) and in the United Kingdom (in October and December); the economic policies of these countries remained otherwise unchanged. Short-term market rates tended to reflect these discount rate reductions, and the gap between United States short-term interest rates and those abroad was reduced in the last months of the year.

With the slowing down of the expansion in the industrial countries, the rise of world trade also slowed down. While exports of the United States and Japan continued to rise, those of other industrial countries declined somewhat in the second quarter and rose only moderately thereafter (Table 8). Exports of the nonindustrial countries in the aggregate remained at about the level reached in the second half of 1959, and many of these countries continued to be seriously affected by the price weaknesses of many primary commodities—both agricultural and mineral products—which became more pronounced in the second half of the year. At the same

TABLE 8.—*World exports, 1959–60*

[Billions of dollars]

Country or area	1959				1960		
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter [1]
	Seasonally adjusted annual rates						
World total [2]	94.2	97.9	103.5	106.0	111.0	110.8	111.5
United States [3]	15.6	15.8	17.2	16.8	18.6	19.6	19.9
All other countries	78.6	82.1	86.3	89.2	92.4	91.2	91.6
Other industrial countries	48.2	51.1	52.8	55.7	59.1	57.4	58.3
Continental OEEC countries [4]	30.9	32.3	33.7	35.7	38.4	37.7	38.0
United Kingdom	9.1	9.7	9.7	10.2	10.6	10.3	10.1
Canada	5.1	5.7	5.8	6.1	6.4	5.4	5.9
Japan	3.1	3.4	3.6	3.7	3.7	4.0	4.3
Nonindustrial countries	30.4	31.0	33.5	33.5	33.3	33.8	33.3
	Unadjusted annual rates						
Nonindustrial countries	30.6	32.8	32.2	34.8	33.7	33.6	32.2
Sterling area, excluding United Kingdom	12.5	13.3	13.3	14.7	14.7	[1] 14.2	(5)
Latin American Republics	8.3	8.4	8.4	7.9	[1] 8.2	[1] 8.4	8.2
All other	9.8	11.1	10.5	12.2	[1] 10.8	[1] 11.0	(5)

[1] Preliminary.
[2] Excludes Soviet Area and Communist China.
[3] Excludes military-aid shipments.
[4] Excludes Spain.
[5] Not available.

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

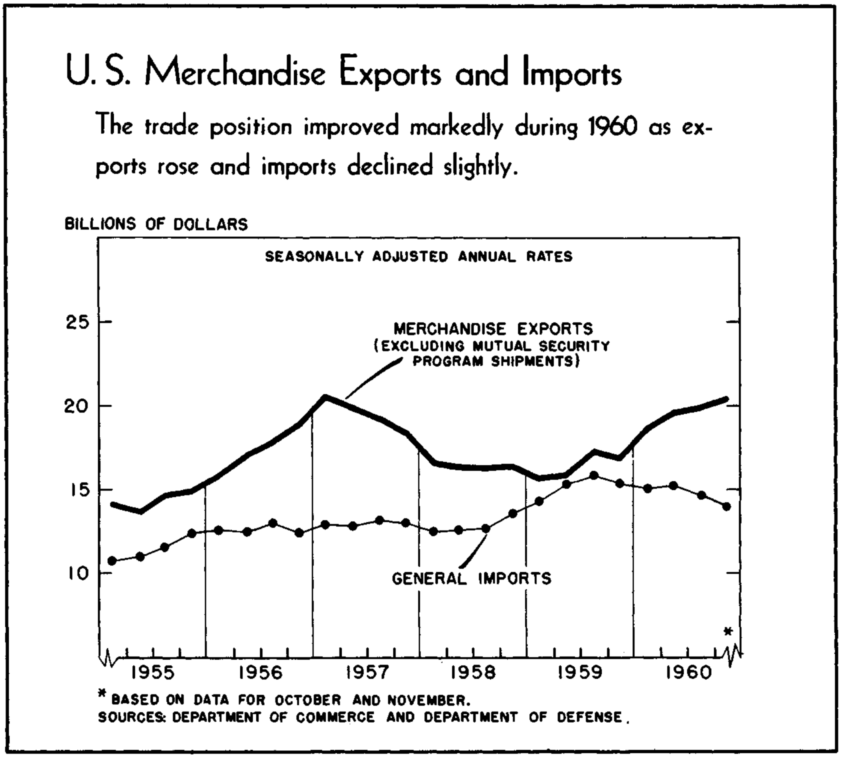
Sources: International Monetary Fund, and Department of Commerce.

time, however, comprehensive economic stabilization programs helped to put the economies of many of the nonindustrial countries on a sounder footing and thus to assure better balanced growth. The United States continued to participate actively in international studies of the trade problems of these countries.

United States Payments Deficit

After showing sluggishness in 1958 and the early part of 1959, United States exports staged a rapid comeback in 1960. By the third quarter, merchandise exports reached an annual rate of $20 billion (seasonally adjusted), 30 percent above their early 1959 low, and the high rate continued in October and November (Chart 17). Imports declined in the third quarter to an annual rate of less than $15 billion and fell further in the closing months of the year. Much of the increase in the merchandise trade surplus reflected the high level of economic activity in Western Europe and Japan and the slowing down in this country. Exports, in addition, received a temporary stimulus from special demand conditions relating to jet aircraft and to cotton in the first part of the year. Export and import trends indicate that many United States manufacturers are successfully

CHART 17



adjusting the prices and designs of their products to meet foreign competition. (For a more detailed discussion of United States Foreign Trade and Payments, see Appendix B.)

The United States continued its generally nonrestrictive import policy in 1960. Only one restrictive action was taken under the safeguarding provisions of our trade agreements legislation, and the Tariff Commission disposed of eight other cases without finding of injury. At the close of the year, final decisions had not yet been taken on two cases in which the Tariff Commissioners were equally divided in their findings. The United States also announced a new set of tariffs on wool fabrics, to replace a tariff quota system, and extended for three years the existing quota on imports of tung oil and tung nuts. Preparations were made for United States participation in the general round of tariff negotiations to be held in 1961 under the auspices of the General Agreement on Tariffs and Trade (GATT).

In contrast to the rapid improvement of the merchandise trade surplus, the net deficit on service transactions in the first three quarters of 1960 changed little from the $1 billion rate of both 1958 and 1959, although both payments and receipts continued to grow. Net outflows of Government loans, grants and pensions, private remittances, and United States private long-term capital, which together have ranged from $5 billion to $6

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billion a year since 1956, changed little in the aggregate between the first three quarters of 1959 and of 1960.

Government assistance to the less developed countries retained its high priority. During the 12 months ended September 1960, dollar disbursements under the Mutual Security Program for economic and technical assistance totaled $1.6 billion. Of this amount, $200 million was disbursed by the Development Loan Fund, which at the end of the period had undisbursed commitments of $1.2 billion. Under Public Law 480, agricultural surpluses were disposed of against local currencies to the amount of $740 million, and, in addition, grants amounting to $170 million were made. The Export-Import Bank disbursed $407 million in loans and committed $495 million, while receiving repayments of $656 million. The United States also paid $80 million in June 1960 on its subscription to the newly established Inter-American Development Bank, and $74 million in November 1960 on its subscription to the new International Development Association.

Flows of liquid funds shifted dramatically against the United States in 1960. This change was reflected in both recorded outflows and unrecorded transactions, so-called "errors and omissions"; for the year as a whole, it appears to have offset much of the improvement in United States trade accounts. The outflow, which increased after midyear as interest rate differentials widened further, took various forms, including short-term investments, bank loans, and repatriation by foreigners of liquid holdings in the United States. Some of the bank loans, however, were not related so much to changing money market conditions in major centers abroad as to needs of certain less developed countries for balance of payments support. Some United States and foreign funds moved into longer-term interest-bearing securities abroad, particularly after the first months of the year. There also were shifts of funds invested in equities, in response to changing market conditions on the two sides of the Atlantic. The flows of some funds were influenced, during the summer and fall, by heightened uncertainties in the political situation in some areas and in world economic conditions. Much of the year's outflow of liquid funds went to the United Kingdom and several countries in continental Europe, which hold a large proportion of their official reserves in gold, and thus increased the pressure on the gold supply of the United States.

Short-term capital outflows enlarged the payments deficit only to the extent that these outflows were exports of short-term funds by United States residents. The repatriation by nonresidents of recorded short-term foreign funds held in the United States did not increase the recorded payments deficit, but by adding to foreign official dollar balances it swelled the demand for United States gold. Outflows of United States owned short-term funds increased the payments deficit, even though they were matched by a rise in United States liquid claims on other countries. Under United States balance of payments accounting, the payments deficit is measured by the increase in liquid dollar liabilities and the decline in the gold stock.

Policies for Reducing the Payments Deficit

To help speed the attainment of a reasonable equilibrium in the United States balance of payments, the Administration in 1960 intensified policies instituted earlier when the recovery by the once war-devastated nations of their competitive strength had become evident. The effort centered on measures to increase United States exports and to reduce the balance of payments impact of Government military and economic programs abroad in a manner consistent with our responsibilities and long-standing policies. Underlying these steps were equally important policies relating to the domestic economy. Fiscal and monetary policies had as one of their major objectives the maintenance of confidence in the dollar as a sound and reliable currency. In this connection, the Administration continued to emphasize the importance of appropriate action by management and labor to insure the competitiveness of United States goods at home and abroad.

To support the efforts of private business in enlarging sales abroad, the Federal Government, with the cooperation of private business, instituted early in 1960 a National Export Expansion Program—a series of coordinated measures to improve and expand Government services in private industry. Measures were adopted to gain the help of existing national and local business groups, to assist and encourage businessmen newly entering the export field, and to strengthen contacts with business groups abroad. To place United States exporters on a more equal basis with exporters in other industrial countries, the Export-Import Bank introduced a new program of guarantees of noncommercial risks for short-term credits and expanded its existing facilities for medium-term export credits and guarantees. The United States also continued to urge other countries—particularly the economically and financially strong ones—to eliminate remaining discriminatory restrictions on United States goods and services and to lower tariffs and other barriers to trade.

Toward the end of the year, the United States initiated a number of coordinated measures designed to obtain substantial foreign exchange savings in its Government expenditures abroad without reducing its military strength or impairing its international commitments. Steps were formulated to reduce gradually and then limit the number of dependents abroad of Defense Department personnel, particularly in the highly industrialized countries with strong currencies, and to cut back Defense Department procurement of foreign goods and services and other expenditures abroad. Other departments and agencies which have personnel abroad and which engage in procurement abroad were instructed to institute similar programs. In addition, the question of the cost of the United States troops in Germany came under discussion by the United States and German Governments. To minimize the balance of payments effects of our economic aid programs, the International Cooperation Administration was instructed to place primary emphasis on financing goods and services of United States origin in all of its foreign aid activities, and as far as practicable to discontinue offshore procurement in 19 countries with strong currencies. Similarly, the Development Loan Fund, which had adopted a similar policy in October 1959, was instructed to reduce procurement outside of the United States to the lowest possible figure.

In addition, efforts were increased to ensure that sales under the agricultural surplus disposal and related programs do not reduce cash dollar sales of United States products. International institutions were urged to use currencies other than dollars as fully as possible, and other strong countries were encouraged to permit borrowing in their capital markets by these institutions and by other borrowers, where appropriate. On January 14, the regulations that have been in force for a number of years prohibiting the holding of gold in the United States were uniformly extended to holdings of gold abroad by persons and business organizations subject to the jurisdiction of the United States.

International Economic Policies

Most countries continued in 1960 to move toward the free and multilateral trade and payments system which has been the goal of the United States since the end of the war and for which the United States has pressed with particular vigor in the last few years. By now, discrimination against United States exports has diminished very substantially; the major remaining quantitative trade restrictions on United States exports are against agricultural products, particularly in Western Europe. Foreign restrictions on capital transactions, however, continue to be considerable. The United States Government expects that there will be continued progress in the dismantling of restrictions on world trade and payments. In particular, the great economic strength of the countries belonging to the European Economic Community and the European Free Trade Association should facilitate a significant lowering of tariff barriers during the forthcoming Geneva GATT negotiations.

The institutional framework of world finance was improved in 1960 through the establishment of the International Development Association and the Inter-American Development Bank. The United States announced new aid programs for Latin America, and further advances were made in the area of *ad hoc* multilateral cooperative efforts for development, most notably the Indus River Basin project.

The United States continued to stress the need for a strengthened determination by all the industrial countries to share in providing funds to the less developed parts of the free world. At the initiative of the United States, the major industrial countries early in 1960 formed a Development Assistance Group to discuss methods for providing such aid. It is planned to incorporate the work of this group in the Organization for Economic Cooperation and Development (OECD), the successor organization to the Organization for European Economic Cooperation (OEEC), which is scheduled to come into existence in 1961, following ratification of its convention, and which is to comprise the 18 Western European members of the reconstituted OEEC together with Canada and the United States. The objectives of this organization will be to achieve the highest sustainable economic growth in member countries, to contribute to sound economic expansion in countries in the process of development, and to contribute to the expansion of world trade.

Along with these advances, the problem of shifts of short-term funds from one international center to another came to the fore during 1960. Now that freedom for international short-term capital movements has been substantially enlarged, and the economies of the major countries abroad have been greatly strengthened, it appears that interest rate considerations may have an increasing influence on short-term capital flows. However, the international financial mechanism today seems strong and flexible enough to allow solutions to the resulting difficulties to be worked out.

International payments, other than short-term capital movements, also have continued to show an imbalance. As a result of this over-all lack of balance in world payments, the substantial increases of international reserves of recent years continued to be concentrated in a small number of countries, particularly in continental Europe. Originally, this inflow was justified by the extremely low level of reserves of these war-devastated countries, but today the reserves of most of them, by and large, seem ample.

The United States has many responsibilities in the world economy. These include keeping the dollar strong, in view of its key role in international trade and payments, maintaining liberal commercial relationships with other countries, contributing to the defense of the free world, and supplying a share of the capital resources needed by less developed countries. The United States can meet these responsibilities because of its resourceful and flexible economy and its international reserves which, with an available gold stock of about $17½ billion, are large. But the United States cannot play its part fully unless other industrialized nations pursue policies required by their positions in the world economy. This fact is now increasingly recognized. A helpful start has been made in the sharing of development costs and other burdens and in the cooperative reduction of existing payments imbalances, but further efforts are needed if the international financial mechanism is to work properly and the free world's economy is to move ahead steadily.

Outlook

As pointed out in this chapter, economic activity continues high as the year 1961 begins, despite the declines in production and employment that have occurred since the middle of 1960. The Nation's total output of goods and services is below the level reached in the second quarter of 1960, but the difference, in constant prices, is only slightly more than 1 percent. And the decline is less than the effect on gross national product accounts produced by inventory changes; final demand for goods and services, which is the total of expenditures in the economy exclusive of inventory adjustment, has continued to move upward. It rose $4.6 billion, on an annual rate basis, in the last quarter of 1960, to a total of $507.5 billion.

There have been production declines in a wide range of industries, but the greatest declines have been in those industries affected by inventory changes, which were in part a result of the extended steel strike of 1959. Thus, while total industrial production in December 1960 was 7 percent below the January high, output of iron and steel was 45 percent lower, and the decline in industries other than steel was less than 5 percent. After midyear, employment also declined, as did wage and salary disbursements. These tendencies became more pronounced in December, and unemployment rose sharply. Total income payments to individuals, which had been relatively well maintained, declined in December.

The fact that aggregate output has been fairly steady despite the large inventory adjustment—from accumulation at the annual rate of $11.4 billion in the first quarter of 1960 to liquidation at the rate of $4.0 billion in the fourth quarter of the year—reflects the underlying strength of the current situation and is a distinctly favorable factor in the economic outlook at this time. It is also favorable to the outlook that major maladjustments which, to be corrected, would require prolonged contraction have not been created in the period of advance that began in 1958, or in recent months when activity has been either stable or moderately declining. Businessmen and consumers have kept their use of credit within reasonable limits and appear to have avoided commitments that might lead to significant corrective changes. Inflationary pressure has been restrained; while this restraint may, for a time, have affected inventory policies and perhaps other demands for goods and services, it has helped prepare a solid foundation for a resumption of sustainable growth.

The principal adjustment still in process is in the inventory area. Further reductions will probably occur during the early part of 1961; but if consumer expenditures are well maintained in the coming months, as they typically have been during recent periods of business hesitancy, the rate at which this inventory reduction is carried forward should soon diminish. A return to inventory accumulation may take somewhat longer, but stocks in some lines already appear low and, even with a reduced rate of liquidation of existing holdings, an increase in production would be required.

The export balance may continue for some time to add strength to the economy. It showed an additional increase in the final quarter of 1960, but the impulses emanating from the boom in Europe and Japan are not likely to continue indefinitely without some slackening.

Government outlays may be expected to rise materially during 1961. Federal budgetary expenditures proposed for the fiscal year 1962 are $1.9 billion higher than for fiscal 1961; and State and local expenditures are likely to continue their rise in response to the needs of our growing population.

Housing expenditures, which tended to level off toward the end of 1960 from a decline that began in 1959, should become an expansive factor in 1961. The volume of construction has benefited from an easier availability of credit, but not substantially, so far, from a cheapening of its cost. Recently, however, the flow of funds into major savings institutions has materially increased, which should eventually lower borrowing costs and exert an expansive influence on all aspects of construction.

It is unlikely that business expenditures for fixed investment will contribute to an increase in demand and production in the immediate future. Capacity is being utilized at less than optimum rates in many industries and, what is of major importance, the trend of corporate profits has not been favorable. Surveys of business capital investment plans and of appropriations for such investment suggest that, for a while, these expenditures may continue to decline moderately from the near-record levels reached in 1960. But they will rise as advances occur in other sectors of the economy and as accelerating activity in research and development creates new opportunities for enterprise.

Consumer outlays may be expected to increase as the factors of expansion raise personal income, and especially if the prices of consumer goods remain free from inflationary pressures.

An increase in general economic activity should not, accordingly, be long delayed. It will be aided by actions already taken in areas of public policy. Credit conditions have been eased materially by the Federal Reserve authorities. A number of steps have been taken by the Executive Branch to stimulate home building. And prompt legislative action on appropriations in 1960 made possible an acceleration of Federal construction and procurement generally. Highway construction was also accelerated. An increase in production, to which these actions contribute, may well become evident prior to a resumption of gains in employment and reductions in unemployment.

The outlook for the United States balance of payments has become dependent not only on changes in exports and imports, but also, in considerable measure, upon the movement of liquid capital. In the balance of trade, some further improvement may be ahead, at least in the early part of 1961. Exports of manufactured products are expected to rise moderately, in response partly to the strong demand in many industrial economies abroad, some of which are operating close to full capacity. Greater domestic procurement under our economic aid programs should also be reflected before long in export gains. At the same time, however, exports of some materials for which demand was particularly strong in the middle of 1960 may continue to decline. An easing in economic activity in the industrial countries abroad would, of course, react unfavorably upon United States exports.

Merchandise imports may be expected to reflect developments in the domestic economy and to increase with a resumption of our general economic advance—though perhaps with some lag. Circumstances that tended to limit imports of automobiles, petroleum, and foodstuffs in 1960 may continue to exert a restraining influence upon total imports in 1961.

Although the measures taken to curtail United States military expenditures abroad point to a further decline in these outlays, the net deficit on services is unlikely to be much reduced, owing to compensating changes under other headings. Private capital transactions, particularly those of a short-term character, may well show considerable improvement, provided inflationary developments are avoided. Direct investments abroad may be lower than in 1960, and an advance in the domestic economy may attract equity funds to the United States. Most importantly, a resumption of advancing activity here may reduce the margin by which short-term interest rates in leading foreign centers exceed those in this country. Although some of the favorable factors may not continue throughout the year, present prospects favor a reduction in the over-all balance of payments deficit in 1961 as a whole.

As expansion is resumed, there is a good chance to realize more fully our economy's potential for growth. The basis for advance has been laid in recent years in the enlargement and improvement of our productive capacity and in policies that have brought the forces of inflation under control. Some temporary acceleration of growth might have been achieved if expectations of price increases had been allowed to persist and to become firmly rooted. But the unsustainable nature of such growth would now be confronting the economy with the need for far-reaching and painful correction. Because action to maintain stability and balance and to consolidate gains was taken in good time, the economy can now look forward, provided public and private policies are favorable, to a period of sound growth from a firm base.

Chapter 2

Experience Under the Employment Act of 1946

THE REVIEW of developments in our economy is extended in this chapter to the whole period covered by the Employment Act, and particularly to the interval spanned by this Administration. In this connection, it is appropriate to recall the background and meaning of the Employment Act, and to point to some of the lessons that may be drawn from experience in administering it.

Background and Meaning of the Employment Act

From its beginning, the United States economy has been organized on the basis of maximum opportunity for private competitive enterprise and the widest possible latitude for personal choice in making a living and spending one's income. Any narrowing of the horizons for individual initiative is alien to the nature of our enterprise system; and when controls and unusual restrictions on personal action have had to be introduced during an emergency, their abandonment at the end of the temporary period of crisis has been awaited impatiently.

In this tradition, the Nation approached cautiously the problem of Federal intervention respecting employment and the maintenance of economic activity generally. Appeals for such intervention were resisted, for example, during the sharp economic downturn in 1921, when occasional depressions were still regarded as inevitable and the belief that they could be significantly moderated through governmental action had not taken hold. But a step taken that year was important for later developments: the President's Conference on Unemployment was established to make studies that would increase understanding of the operation of our economy and thus help to avoid the recurrence of widespread joblessness. The work of this Conference, which made its final report only shortly before the Great Depression began, was reflected in the Employment Stabilization Act of 1931, which sought to provide for "advance planning and regulated construction of public works, for the stabilization of industry, and for aiding in the prevention of unemployment during periods of business depression."

Despite a series of countermeasures, the heavy unemployment of the 1930's persisted until the tremendous increase in production required in World War II and the service of 11½ million persons in the Armed Forces reduced it to a minimum and created even a degree of overemployment. With the turn in the tide of war, however, memory of deep depression in the 1930's and the expected demobilization of the Armed Forces heightened concern for the Nation's economic future and aroused a keen interest in measures to help avoid the widespread unemployment that it was feared would result from demobilization and reduced spending on arms.

It was in this atmosphere of concern that the Congress turned its attention to legislative measures to cope with unemployment, should it emerge as a serious postwar problem. Congressional staff committees made comprehensive studies of the incidence and duration of unemployment and of possible methods for dealing with it. Extensive hearings were held, and a bill, the Full Employment Act of 1945, was introduced in Congress, providing for a considerably broader attack on unemployment than the public works program envisioned in the Employment Stabilization Act of 1931. The bill failed of enactment, but subsequently a revised version, the Employment Act of 1946, was passed overwhelmingly with bipartisan support in both houses of the Congress.

At the time it was approved, the Employment Act represented a major extension of our traditional concept of shared private and public responsibility for the Nation's economic growth and improvement. It gave explicit expression to a continuing interest on the part of the Federal Government in aspects of economic life that, outside the sphere of monetary policy, had previously received deliberate Federal attention only in such emergency conditions as depression and war.

It is useful to recall the language of the Act's declaration of policy: "The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power."

Thus, the Employment Act states that it shall be the policy of the Federal Government to promote conditions under which there will be afforded employment opportunities by methods that are consistent with the traditional American philosophy of individual freedom and competitive enterprise. Although the Act enlarges the area of explicit Federal concern to include the quality of our current and expected economic accomplishment, it does so without diminishing the scope of private, State, and local responsibility. Far from seeking to centralize economic decision-making in the Federal Government, or even to confer predominant responsibility for economic growth and improvement on the Federal Government, the law explicitly acknowledges the multiple sources of economic strength in private individuals and groups and at the several levels of government. The theme of the Act is captured in a phrase used in the Economic Report of 1960 and in the present one: "shared responsibility for economic growth and improvement." This principle, manifest in our economic life as in other aspects of the American way, has carried us to the highest material well-being ever achieved, without hobbling the human spirit and without impairing our political freedoms.

The framers of the Act proposed high standards of economic achievement. They wisely omitted, however, any requirement that economic goals be publicly stated as fixed quantitative targets, although this fact gives no ground for indifference to failure to attain the best levels of production, employment, and income that are feasible and sustainable for any period. Such a requirement could invite broad, irreversible intervention by the Federal Government if the projected targets were not reached. The Act instead contemplates a framework in which the mainsprings of private individual initiative continue to function in behalf of brisk economic activity, and in which the individual retains a wide freedom of choice. In our economic system, the level of achievement is everyone's responsibility and cannot be guaranteed by the Federal Government acting alone.

It should be noted, also, that the Act states that the Nation's economic objectives should be pursued with due regard to other Federal objectives and obligations, which must include a stable currency and protection of the value of the dollar. The goals of economic policy, furthermore, are not ranked. They have to be pursued coordinately; emphasis on one to the neglect of others would soon prove self-defeating.

Adjustment From Wartime to Peacetime Economy

When the Employment Act was passed in 1946, our economy was making the extensive readjustments required of a Nation in transition from war to peace. A year earlier, economic resources were still extensively committed to war and defense. Of the Nation's total output of about $215 billion, expressed in current values, roughly one-third was for military purposes; and 11½ million Americans, nearly one out of every twelve in our population, were in the Armed Forces. Within a year's time, the proportion of our national output devoted to defense had been cut to less than 10 percent, and 8 million men and women had been demobilized.

Although this sweeping readjustment was not made without difficulty, it was completed with but a small rise in unemployment and with a relatively small drop in the Nation's output of goods and services. Sharp increases in the production of consumer goods and services, a quadrupling of the rate of expenditures on home building, and a great surge of investment by businessmen in new productive capacity and in the rebuilding of depleted inventories came close to offsetting the large cutback in defense output. The year 1946, in which the Employment Act was passed, marks the beginning, therefore, of a period in which the central economic problem has been that of sustaining stable, inflation-free economic growth despite still large defense and defense-related burdens. It is, for this reason, a good starting point from which to review the performance of our economy against the standards implicit in the Employment Act.

Expansion of National Output

The postwar years have witnessed an enormous expansion of the Nation's annual output. Measured in current prices, the value of goods and services produced—gross national product—expanded from $234 billion in 1947 to more than $500 billion in 1960. After adjustment of these values to eliminate the effect of price rises, which were persistent and substantial during most of this period, it is seen that output rose by nearly 60 percent, or at an average rate of approximately 3½ percent a year. By this broad measure, our economy's rate of expansion in the period of the Employment Act has exceeded by a significant degree the rate of growth from the beginning of this century to World War II.

All major components of output expanded at a high rate. Business fixed investment, which is largely for constructing and equipping new or improved productive facilities, increased rapidly as wartime deferrals were made up and extensive modernization programs were carried out. Nearly $650 billion (in 1960 prices) was invested for these purposes in the 1946–60 period, equaling, in real terms, almost three times the investment of the previous 15 years. The output of consumption goods and services rose more than 50 percent. Home construction increased at a rate of about 7 percent per year; almost 20 million dwelling units were completed, a number equal to about half the supply of homes available when the war ended. By the end of the 15-year period, the housing shortage which had been so acute when war ended had been eliminated, and—what is especially important for the vitality and strength of our free institutions—some 60 percent of all dwelling units are now occupied by home owners.

Total purchases of goods and services for use by or through government also increased markedly. Federal, State, and local government purchases, as a total, almost tripled between 1946 and 1960; currently, they comprise almost one-fifth of the Nation's total output. In the years since 1952, State and local expenditures for education have more than doubled; and those for public health and sanitation, for highway construction, and for general government purposes have increased almost as rapidly.

Although the amount of the Nation's total output of goods and services that was directed to defense purposes remained high throughout the 15-year period, and especially after 1950, the proportion in 1960 was lower than in 1952; reflecting this, the output of goods and services for civilian use increased at a higher rate than total output. Thus, while total output increased from 1952 to 1960 by close to 25 percent, or at a rate of 2.7

percent per year, the use of goods and services for consumption, which includes private expenditures on education and medical care as well as all other consumer purchases, rose about 30 percent, or 3.6 percent a year. Expenditures on residential construction rose more than 40 percent, or 4.4 percent a year. Purchases of goods and services by State and local governments, through which community needs that cannot be met by private effort are traditionally satisfied, rose nearly 60 percent, or 5.9 percent a year, more rapidly than any other single major component of national output.

Growth of Resources for Production

This impressive expansion of output illustrates the high and rising productive capability of our enterprise economy. Whether comparable or superior gains in real output occur in the future will depend in good part on the extent to which the resource base of our economy is maintained and strengthened through balanced growth. Therefore, it is a good augury for the future that significant increases and improvements in the quality of our productive resources have been registered in recent years.

First, our total labor force has increased at a rapid rate, substantially above what was expected when the Employment Act was passed; increases since 1946 have averaged about 850,000 a year. And there has been a marked improvement in the educational background and training of the labor force. In 1940, about 30 percent of the labor force 18 to 64 years of age had graduated from high school and 5 percent were college graduates; in 1959, the respective proportions were more than 50 percent and 10 percent. And in the age group 18 to 34, the representation of high school graduates rose during this period from 40 percent to 60 percent, and of college graduates from 5 percent to 10 percent. Since 1952, increases in school enrollments and in the numbers receiving college degrees have been especially large. The proportion of all persons 5 to 34 years of age enrolled in school rose from 47 percent in 1952 to 56 percent in 1960. As would be expected, educational enrollment increases were most rapid in the older age groups, reflecting the national trend toward wider participation in college and postgraduate studies. Also important has been the increasingly frequent establishment of on-the-job education and training programs by business firms, private trade schools, and labor organizations.

Second, as mentioned above, the Nation's stock of capital has been enlarged by substantial annual investments in new plant and in new machinery and equipment. As a result, the productive capacity of our economy has been greatly increased. This was especially true in the years immediately after World War II, when deficiencies that had developed during the war were made up, but the rate of increase has been high also in the past eight years. Increases since World War II in the capacity for producing steel, refining petroleum, and manufacturing paper range from 60 to 80 percent, and in other industries, such as aluminum, the growth has been even more rapid. The capacity of our transportation system has likewise been greatly expanded.

Third, the Nation's intangible capital has been greatly augmented through heightened activity in research and development. Total expenditures for these purposes can be estimated only very roughly, but they are placed at about $13.5 billion a year at the present time, having risen sharply from about $1.8 billion in 1946. Even though somewhat more than one-half of this cost is Government financed and much of it is oriented toward military purposes, the benefits to private industry and to civilian objectives are real, persistent, and large.

Such increases in the Nation's stock of tangible and intangible capital, together with the improved skills of our working people and improved methods of business management, have been reflected in substantial improvements in productivity. Although there is no clear evidence that the rate of this improvement has accelerated in the years since 1946, it appears to have been higher, on the average, since the end of World War I than in the 30 years prior to 1919. The volume of output per man-hour of labor performed, one measure of productivity, continues on an upward trend, though year-to-year changes remain irregular and occasionally are downward.

Strengthening of Our Enterprise System

The continuing vigor of the competitive enterprise system, which Government is called upon to foster and strengthen under the Employment Act, is clearly manifest in developments since 1946.

The rate of formation of new businesses was especially high in the closing years of World War II and the years immediately following, and it has continued high since then. Although the rate of discontinuance of businesses, including the termination of enterprises by failure, has tended to rise, the business population has made significant gains. The number of operating businesses has risen since 1946 by nearly 1.5 million, reaching more than 4.7 million in 1960. This rapid increase bespeaks the continuing openness of our enterprise system.

Two other sets of facts reflect the opportunity for entry into business, for innovation, and for success in business operation. First, recent studies have shown no clearly defined general tendency toward greater concentration in American industry, despite growth in the size of many individual concerns. While concentration has increased in some industries, the opposite trend is visible in others. Second, there has been a marked increase in the rate at which new products and new processes have been introduced, doubtless reflecting the greatly increased accent on research and development noted above. Large companies are in a good position to conduct research and development activities on an intensive basis, but small firms also play an important part in the introduction of new products and new technology, drawing on their independent research and development efforts and, through licensing arrangements and participation in Government contract work, also on the research results of other firms. Companies of small and medium size have been aided in this connection, as well as in normal business operations, by the ready availability of private advisory and technical services and financing arrangements especially suited to their needs. Steps taken by Government in the last eight years to assist small businesses, and in this way to strengthen our enterprise economy, are described in the *Third Progress Report by the Cabinet Committee on Small Business,* issued in December 1960.

IMPROVEMENT OF PERSONAL SECURITY AND WELFARE

These advances in output and productive capability have made it possible to maintain the large military forces needed for our national security, to assist in the reconstruction of the war-ravaged countries of Europe and the Far East, and to aid in the peaceful development of the less industrialized nations of the world. They also have made possible remarkable improvements in the material well-being, culture, and economic security of the American people.

Since the passage of the Employment Act of 1946, the population of the United States has increased nearly 30 percent; in the same period, disposable personal income (in 1960 prices) has risen from $231 billion to $354 billion, or about 50 percent, and per capita disposable income (also in 1960 prices) from $1,635 to $1,969, or 20 percent. Since 1952, these increases in income have been 30 percent and 15 percent, respectively. Improvements in well-being are also reflected in changes in the distribution of families according to income in constant prices. Thus, 47 percent of all families had incomes of less than $4,000 in 1947, but this proportion had dropped to 35 percent by 1959; at the upper end of the income scale, families with real incomes of $8,000 and over increased during this period from 14 percent of the total to 24 percent.

Means for protecting income and personal financial security have been greatly strengthened. The number of life insurance policy holders rose from 77 million in 1946 to 94 million in 1952 and 118 million in 1960, and the amount of life insurance per family increased from $3,600 to $5,300 and $10,200. Between 1952 and 1959, the number of shareowners in public corporations increased from 6.5 million to 12.5 million.

A rapid extension of private and public systems of insurance has broadened measures to provide personal security in old age and to meet emergencies caused by unemployment, ill health, and death. The number of workers (including farmers and other self-employed persons) covered by the Federal Government's system of old-age, survivors, and disability insurance increased from 36.7 million in 1946 to 50.2 million in 1952 and to 59.0 million in 1960, and the percentage of paid workers covered rose in these periods from 65 to 79 and 87. The total amount paid to those eligible for benefits was $378 million in 1946, $2.2 billion in 1952, and

$11.3 billion in 1960. The number of beneficiaries, which had been 1.6 million in 1946 and 5.0 million in 1952, was nearly 15 million in 1960.

Private insurance to meet health emergencies has also been extended and improved at a rapid rate. The number of persons covered by hospital insurance rose from 42 million in 1946 to 132 million in 1960. At the beginning of this period, 18.6 million persons were insured under private systems for the coverage of surgical expenses and 6.4 million for regular medical expenses; at the end of the period, the coverage of these two types of health expenses was 120 million and 86 million, respectively. Private insurance for major medical expenses has shown the most spectacular increase—from 700,000 persons in 1952 to 25 million in 1960.

Finally, unemployment insurance coverage under the Federal-State system rose from 31.9 million persons in 1946 to 37.0 million in 1952 and 44.0 million in 1960, and the percentage of those employed in nonagricultural establishments who are covered increased from 77 in 1946 and in 1952 to 83 in 1960. Average weekly payments to those out of work were $18.50 in 1946; the average for 1952 was $22.79, and it increased to $32.75 in 1960.

Greater Economic Stability

Although personal security is strengthened by insurance systems both private and public, it depends primarily on a high level of employment, the development of job opportunities for our increasing labor force, and the avoidance of sharp fluctuations in production and employment. The persistence of unemployment in some areas and the recent increase in the total allow no room for complacency, but the record of the past 15 years also shows good performance in maintaining high employment and avoiding wide swings in economic activity.

A large increase in jobs has been achieved since 1946. Total civilian employment rose from 55 million in 1946 to 61 million in 1952 and increased further, to nearly 67 million, in 1960. The number of persons unemployed and the rate of unemployment were somewhat higher, however, in the peacetime years of the 1950's than in the late 1940's. The contractions in economic activity since the Employment Act was passed have proved to be relatively moderate when compared with earlier cyclical adjustments. For example, the contraction that began in August 1957 lasted only 9 months; and the two previous ones, beginning in December 1948 and in August 1953, were ended in 13 and 11 months, respectively. However, the principal improvement in this respect lies in the fact that the declines were less severe than on most earlier occasions. Thus, personal income dropped less than ½ of 1 percent in the contractions beginning in 1953 and 1957, contrasting with declines of 11 percent and 50 percent in the downturns that began in May 1937 and August 1929, respectively. Declines in employment and production were also appreciably smaller than in most earlier cyclical downturns.

The mildness of recent contractions relative to earlier experience reflects, in part, the stabilizing features of our tax system, the automatic operation of governmental programs that help to sustain income when production and employment recede, and a shift in the pattern of employment toward jobs that are relatively less affected by recessionary tendencies. It also reflects deliberate steps taken by the Government to offset the declines, and the greater stability of business enterprises.

While this record presents evidence of good progress, the further moderation of economic fluctuations remains a major challenge to Government and industry. In the contraction that began in August 1957, for example, industrial production fell by 14 percent and total employment by about 2 million even though the decline in personal income was small. The best thought and most determined action are needed to find constructive ways to make further advances in reducing this persisting problem of the enterprise economy.

Lessons of Experience Under the Employment Act

These developments in our economy and the experience gained in administering the Employment Act teach certain lessons that must be kept in mind continually as we strive to attain our national economic objectives.

First, although great strides have been made toward understanding and moderating the cyclical behavior of our economy, difficult problems of diagnosis and prescription remain. Experts disagree on the meaning of unfolding events, and action to counter adverse developments cannot be finely predetermined, either in kind or degree. Moreover, the repercussions of countermeasures cannot be accurately foretold. Experience underlines the importance of the close surveillance of economic developments that is a responsibility of the Council of Economic Advisers, created by the Employment Act. It also emphasizes the need for constant review of administrative actions and legislation, to determine their potential or actual impact on the growth and stability of our economy. In addition, this experience shows the need for up-to-date, accurate, and comprehensive facts on economic developments as a basis for wise policy decisions by private groups as well as government.

Second, a tendency for prices to rise has persisted in the period since World War II, even after prices reflected the inflationary pressures generated by war and even though our resources have not always been utilized to the full. To arrest this tendency, as we have largely succeeded in doing of late, and to attain our national economic goals in an atmosphere of reasonably stable prices must continue to be a major objective of private and public policy. Apart from the other adverse effects of inflation, its seriousness has been underlined by the growing recognition that reasonable stability of costs and prices is essential to balanced economic growth and to the maintenance of our competitive position in world markets.

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Third, competing objectives must be taken into account in economic policy, and action in pursuit of any one goal must be taken with a recognition that to press it too far or too rapidly may prejudice other values that are in reach or in hand. Considerations of long-run benefit must be weighed against short-run advantage. The rate of economic growth cannot be properly evaluated without regard to its composition and balance or its sustainability. On the contrary, the unwholesome accompaniments of a forced, too-rapid expansion may impede further growth and even induce setbacks.

Fourth, it should be clear from the experience under the Employment Act, as it is from the longer history of our country, that Government action is not the principal, let alone the sole, determinant of the rate of economic growth. In our competitive enterprise system, growth requires that productive job opportunities be created in private employment. The creation of jobs, in turn, requires the presence of adequate incentives to private action and the availability of private capital and other needed resources, and it is heavily influenced by the state of demand, prices, and costs, and the desires and interests of the people. The Federal Government promotes economic growth mainly by the contributions that it makes to conditions favorable to the exercise of private, individual initiative and effort, and by facilitating and encouraging the execution of their respective responsibilities by private individuals and groups and by State and local governments.

Fifth, the language of the Act affords a fair degree of flexibility in its administration, which our experience shows to be necessary if economic policy is to accommodate new priorities and meet new challenges. Routine diagnosis and administration have no place in economic policy for growth and stability. The policy appropriate in one situation is not necessarily suitable in a later one, even when the circumstances are alike in many respects. Thus, in 1954, when the economy was undergoing a contraction, it was possible to execute a substantial reduction of taxes, and thereby to increase the purchasing power of individuals and of business firms, because governmental expenditures, previously expanded as a result of the Korean conflict, were being cut back. In the contraction of 1958, on the other hand, different actions were called for and taken: monetary and credit policies were adjusted; Government expenditures were maintained and in some areas increased, at the same time that revenues declined, and a substantial deficit was incurred; administrative actions fostered a higher rate of home building; the Federal-aid highway program was accelerated; and unemployment benefits were extended.

Actions and policies adopted during the period of the Employment Act have not insured against economic contraction, but they have proved effective in moderating setbacks. The Act has fostered a keener awareness of approaching downturns and a determination to meet them by positive action rather than by passive acceptance. And this change in attitude on the part of the Federal Government has created an atmosphere of public confidence which in itself has helped to arrest recessions before they have become cumulative downward spirals.

Sixth, the remarkable advance achieved in the welfare of our citizens provides a basis for confidence in the future growth and improvement of our economy. From this experience it is clear that the same diffusion of power for economic decision-making which would render foolhardy the sole reliance on Federal effort to achieve the Act's objectives assures the broad public and private cooperation needed to attain maximum practicable economic progress. While neither the public nor the private sector can guarantee the final outcome of their policies, the results of their efforts can provide a basis for improving future decisions and performance. Greater public understanding of economic issues, and a better appreciation of the consequences of past decisions and action, help the citizens of a democracy to evaluate proposals to promote the growth and stability of the economy. For the Federal Government, which is the agent of all the people, this evaluation may point to the need for new or revised laws. Also, fulfillment of the Federal role may often be aided by positive statements of principles, needed policies, and goals. For the achievement of the common economic aims of a democratic society, it would be as much a mistake to ignore the value of this manifestation of leadership as to rely upon it solely. Psychological factors should not be overlooked in the emphasis on automatic and deliberate stabilizing and stimulating policies and actions.

In sum, experience has proved the Employment Act to be a helpful instrument for achieving important common economic goals in a framework of free institutions. Confidence that the concepts of economic organization and action embodied in the Act will serve us well in the future has been strengthened. The Act is a living document, adaptable to changing circumstances. Though improvements might be made, as suggested in the next chapter, the Act, even without amendment, can provide a useful guide for policy and action in new and unforeseen circumstances.

Chapter 3

Policies for the Future

A RAPID growth of the labor force and a significant improvement in the Nation's productivity will provide the opportunity and also a challenge to raise output in the next decade at a still higher rate than has been experienced in the years since the Employment Act was passed. Success in accelerating production and providing the needed employment opportunities will depend, of course, on both private and public policies. The gains made in recent years in containing inflationary pressures and stabilizing prices and in avoiding the development of other imbalances in the economy provide a good foundation for achieving the desired rapid and sustainable economic advance. In some areas, however, new Government policies will be needed and existing legislative provisions will have to be strengthened.

It is impossible to say in advance how large the increase in the labor force will actually be, but it is clear that an unusually large number of younger persons will reach working age in the next decade. Indeed, the annual increase in the labor force may average as much as 1.4 million during the decade, compared with an annual growth of 850,000 in recent years. If it is assumed that in the next ten years the average unemployment rate will be equivalent to that for the past decade and that the size of the Armed Forces will remain unchanged, an annual increase of 1.4 million persons in the labor force would raise the number of persons in civilian employment in 1970 to more than 80 million, or 20 percent above the present employment figure.

A gain of this magnitude in employment would imply a still larger advance in output as productivity continues its historic upward course. Our output per man-hour is now substantially higher than that of any other industrialized economy in the world, and it has tended to increase at a long-term average annual rate of 2 percent or more. There are forces at work that could speed the actual gain in the next 10 years. The cost pressures of our enterprise system today and the intensive competition faced in world trade provide spurs to the more rapid achievement of greater productive efficiency. Continuing high expenditures on new plant and equipment and heavy emphasis on research and development are also favorable to a marked advance in productivity.

Fuller realization of our Nation's rising productivity potential could also be fostered by the elimination or reduction of arbitrary impediments of long standing. For example, many rules, codes, and practices that restrict output and hinder the introduction of more efficient techniques deserve to be modified in the national interest, while providing reasonable safeguards for workers. The reduction of deterrents to productivity is an end to which labor and management, with the help of Government, if necessary, should work more intensively in the years ahead. The recent decision to establish a commission concerning railroad work practices has properly been hailed as a step in the right direction.

Although the signs are promising, the rate of economic growth cannot be predicted accurately, since the future size of the work force, the level of employment and hours of work, and the rate of actual productivity advance are themselves uncertain. However, if we succeed in the next 10 years in holding unemployment rates to their average in the 1950's, and if the long-term average rate of increase in productivity persists, the growth of national output would exceed by a significant margin the rate achieved since the Employment Act was passed. A more rapid advance of productivity would yield a still higher rate of growth. This is the opportunity inherent in the present position of our economy and in its longer-term prospects.

Government and Private Policies

In our free economy, economic growth and the improvement of living standards depend not primarily on what government does but mainly on what is done by individuals and groups acting in their private capacities. In this system of shared responsibility, the tempo of economic activity is especially sensitive, for example, to the plans and actions of large firms and powerful labor organizations whose operations are national and international in scope.

Government makes its basic economic contribution not through the volume of its own expenditures but by promoting conditions favorable to the exercise of individual initiative and private effort. Accordingly, a dominant purpose of government at every level must be the preservation and invigoration of institutions that favor and support enterprise. In particular, the Federal Government should encroach no more than necessary on the province of private action. Indeed, it should expand as broadly as possible the opportunities for private decision-making; strengthen incentives for businessmen, workers, savers, and investors; and promote a vigorously competitive environment in domestic and international markets. And within the area of public action, the Federal Government must avoid encroachment on the province of State and local units. The expected increase in the demand for public investment and the emergence of new regional and area problems will require efforts on the part of State and local authorities and of citizens in general to render more effective the instruments of government located close to home. A proper sharing of governmental responsibility may require a strengthening of the capacity of State and local entities to meet their emerging and increasingly heavy burdens.

Maintenance of Price Stability

In administering fiscal and monetary affairs, the Federal Government makes a signal contribution to growth to the extent that it strengthens confidence in the stability of prices. The threat or experience of inflation tends to undermine thrift, even apart from the inequities inflicted and the hazards raised to sustainable growth of production. A steady and ample flow of savings and a growing volume of productive investment have been crucial to the development of our economy and will be needed more than ever in the years ahead if greatly increased numbers of workers are to be supplied with adequate tools and equipment.

Among Government efforts to maintain a reasonably stable price level, special importance must be assigned to the noninflationary conduct of Federal budgetary and fiscal affairs. Rising Government expenditures can put a direct upward pressure on costs and prices—especially when employment is already high—either because of their very magnitude or because they may concentrate demand on economic sectors in which personnel or supplies are relatively limited. Thus, inflationary pressures can be created throughout the economy, encouraging cost and price increases that do not appear directly traceable to Government action. A significantly large budgetary deficit, too, can impair the effectiveness of an anti-inflationary monetary and credit policy. Furthermore, the example set by Government in the conduct of budgetary and fiscal matters influences public attitudes and the psychology of the marketplace.

The second major Government instrument for controlling inflationary tendencies is monetary policy, for which the independent Federal Reserve System is responsible. Increases in credit, deposits, and currency are required to accommodate the rising volume of payments accompanying higher levels of production and employment, even when prices are generally stable. But these increases must be moderated so that they do not directly or indirectly contribute to the erosion of purchasing power.

The specific goals of monetary policy in particular situations and the best means for achieving them must be determined on the basis of long experience and a deep understanding of economic and financial developments at home and abroad. Experts may well differ on paramount short-term objectives, methods, and timing, especially since a wide variety of national interests have to be taken into account; but there should be no difference of opinion as to the unworkability of a policy of forcing interest rates to artificially low levels and keeping them there. Such a policy would be self-defeating, leading eventually to unbridled inflation or to a network of direct controls of wages, prices, and the use of credit.

Another factor bearing on the maintenance of price stability for sound economic growth is the control of unit production costs—a responsibility that in our free society rests primarily with private individuals and groups. An important aspect of cost control is the achievement and maintenance of a proper relationship between wage and productivity changes in the economy as a whole. In general, if average increases in wages and salaries are inconsistent, over the long run, with average improvements in productivity, prices may be expected to trend upward. Wage settlements negotiated by management and labor should not preclude price reductions in parts of the economy where productivity rises especially rapidly. High wages provide a dependable source of increased economic demand only to the extent that they are justified by productivity performance. In the last analysis, the only way to assure that, for the economy as a whole, maximum employment and maximum production also mean maximum purchasing power is to keep wage improvements generally within the range of productivity advance.

The prolonged shutdown of the steel industry in the latter half of 1959 emphasizes another important implication of labor-management negotiations. Failure to achieve prompt, as well as reasonable and realistic, settlements of outstanding differences can lead to imbalances in production rates and inventories. These imbalances, and the attendant uncertainties and disappointments of expectations, can have a harmful effect on economic stability and on the general level of employment. It is important for labor and management to conduct their negotiations and settle their differences in a responsible manner and thus avoid inviting new Government controls and new limitations on their initiative.

The maintenance of price stability is significantly affected also by Government price and income support policies for agriculture. In this area, policies that would raise consumer food prices and tend to increase production costs through compensating wage adjustments must be avoided.

Tax Policy

Taxation is another major area in which Government can contribute significantly to the speed of economic growth. A tax system must, of course, provide the revenues needed to cover governmental expenditures over reasonable periods, though a balance is not required every year. A budgetary surplus in prosperous times helps curb inflationary pressures, and a deficit during a period of recession may help reverse the downturn. More positively, a selective revision of our tax structure is needed to promote incentives and to maintain the vigor of the enterprise system. But it is important that the full benefits of tax revision should not be jeopardized by the hasty improvisation of reductions in the hope of countering cyclical downturns in economic activity.

Opportunities for effective tax revision will be afforded more readily as tax revenues increase with the growth of the economy. Thus, economic expansion at a rate comparable to that achieved in the period since 1946 would yield several billion dollars of additional receipts annually within the existing tax structure. However, the full amount of these potential increases in tax revenues would not be available for new expenditure programs or tax relief, inasmuch as programs undertaken pursuant to legislation already enacted will require increasing outlays in the future. The large veteran population is aging and, under present laws, expenditures for pensions, compensation, and medical care may be expected to grow. The annual cost of the medical care program for the aged enacted in 1960 will take some time to reach a maximum. Many public works projects are still in the early stages of construction, and their annual costs have not yet reached a peak. The civilian space program is expanding, and current appropriations exceed current expenditures. Although anticipated increases in expenditures, such as those just outlined, may be offset by the reduction or termination of some programs, a continuing upward trend in Government spending is foreseen.

Clearly, tax relief depends not only upon the rapid growth of the private sector but also on continuing budgetary discipline; and the chief objective of such relief, with due regard to equity considerations, should be the acceleration of the growth of the national product, especially through the sharpening of incentives for private investment. Government must keep a constant watch over its expenditures and at the same time look for opportunities to effect tax changes that will provide both the greater means and a greater stimulus to economic growth. Many features of the tax revision enacted in 1954 were designed with this dual purpose in view.

Measures to Reduce Unemployment

As the opening section of this chapter implies, further advance toward moderating cyclical fluctuations in the volume of employment could contribute significantly to more rapid economic growth. Maintenance of reasonable price stability would give strong support to other efforts in this direction. Federal and State governments must be prepared to take positive steps to counteract or moderate the impact of declines. In addition to making prior provision for automatically cushioning economic contraction, they may have to enact emergency measures, if these are warranted, or to incur temporary budgetary deficits.

Steadier and fuller employment of the labor force, which presents the greatest and most complex challenge to public and private policy, is a problem that has structural as well as cyclical aspects. The problem cannot be resolved only by the moderation of fluctuations in economic activity as a whole; a continual, more effective matching of labor supply and demand in specific geographic areas, industries, and occupations is also required. Such matching must be as smooth as possible in order to overcome dislocations incident to technological change, the transition from agriculture to industry, long-term shifts in product demand and industry location, and international competition. While corrections of these conditions are found most readily in a stable and prosperous economy, special remedial measures also are required. Although the Federal Government cannot assume the major responsibility for such measures, it can participate effectively in a joint, many-sided program.

Above all, well directed local efforts must be made to develop new industries in areas of relatively high and persistent unemployment and underemployment. Technical assistance is currently available from the Federal Government, but legislative authority to extend and strengthen existing programs and to make available a new program of financial assistance is urgently needed.

The Economic Report of January 1960 pointed out that legislation to facilitate structural adjustments should meet several tests. It should be designed to stimulate and complement the efforts of local communities and citizens' groups to help themselves, promoting as much direct participation as possible on the part of private financial institutions and of State and local agencies. It should concentrate on areas in greatest need of assistance and avoid dispersing funds over wide regions with little lasting effect. It should encourage the creation of new job opportunities, not merely the transfer of jobs from one part of the country to another. It should include provision for technical aid in the economic diversification of rural low-income areas and of single-industry communities, as well as assistance for communities of a predominantly industrial character. And it should encourage programs of vocational training and retraining to upgrade the qualifications for new jobs of residents in areas of persistent unemployment and underemployment.

More general measures are needed to ease existing hardships and to limit the spread of distress to other areas not now affected. Thus, greater attention must be given to the change in the pattern of employment opportunities in the direction of occupations and professions requiring higher levels of education and training. The trend away from heavy, unskilled labor may be expected to continue or even quicken as our technology progresses. Therefore, maximum future employment depends in part on the timeliness and success of private and public efforts to adapt our labor force by improving job counseling and placement, by strengthening vocational education and training, by eliminating discrimination in the labor market, by raising standards of educational achievement, and by increasing the number of competent teachers.

Education and Health Services

Advances in education are, of course, important from more standpoints than the enhancement of employability. Along with improvements in health, they raise the Nation's productivity potential, provide a key to greater individual well-being and security, and add to the quality and diversity of social life.

Though standards and performance in the fields of education have steadily progressed, much remains to be accomplished. Our educational institutions must prepare for much greater numbers of high school, college, and graduate students. While enrollment in public elementary schools may rise by nearly 2.9 million, or 12 percent, over the next eight years, the number of students in public secondary schools is expected to increase by 3.8 million, or about 30 percent. Furthermore, the number of students attending colleges and universities, now about 4.0 million, may increase by another 2.3 million, or nearly 60 percent.

This growth will require a huge expansion of the Nation's commitment to education. Primary responsibility for meeting the demand should remain with local and State governments and with private groups, as the Federal Government provides important supplements. Federal financial assistance to education will reach about $1 billion in 1962, and this amount does not take into account educational benefits from Federal outlays of billions of dollars a year for research and development. Our educational institutions also derive large financial benefits from the tax treatment of contributions made to them.

Like education, health activities will provide both supports and outlets for accelerated economic advance. Basic studies of the emerging needs in these areas and of public and private roles in meeting them have been made under Government sponsorship. As the population continues to grow rapidly and living standards rise, the Nation's demands for health services will greatly expand. More than $25 billion—three fourths from private sources—is being expended annually on health. Federal expenditures, including outlays of the National Institutes of Health for medical research and training and the medical program of the Veterans Administration, will amount to about $2.2 billion in the fiscal year 1962, compared with $2.0 billion in the current fiscal year and $1.8 billion in fiscal 1960; within the 1962 total, Federal expenditures for hospital construction, mainly grants, are estimated at $236 million, an increase of 7 percent over such expenditures in the current fiscal year. Important Government action was taken last year to improve health services for needy older people, but more remains to be done under private as well as public auspices. Especially, increasing attention has to be directed toward augmenting the number of doctors and dentists as the population expands. A new 5-year, $100 million program of grants for the construction of medical and dental schools has been proposed.

Some improvements will be needed in Government programs of social insurance that supplement private provisions for protection against the hazards and hardships of income loss through unemployment, old age, disability, and death. In addition to their value in alleviating personal hardships, these programs have demonstrated their usefulness in helping achieve economic growth and stability. Minimum wage laws also, when carefully designed and administered, help safeguard wage standards for workers at the fringes of competitive labor markets and encourage the spread of more efficient productive techniques.

International Responsibilities

Economic growth requirements must be viewed in the light of our international responsibilities as well as our constant striving for domestic improvement. Despite the great contributions made toward the progress of the less developed countries, further vast efforts are required to help raise their living standards. We hope that, in the future, the nations we helped in their time of critical need and which have now regained their economic strength will participate more fully in bilateral and broader joint programs of investment, grants, and technical aid.

For our part, we can discharge our international obligations most effectively if we achieve sound as well as rapid economic growth. This means that public and private efforts to speed the expansion of our national product should avoid inflation, aim at solution of our balance of payments difficulties, maintain world confidence in the value of the dollar, and strengthen our competitive position in world markets. We may expect our allies to play a major role in the common defense and in the expansion of the world economy, but the principal burden of leadership in the quest for peace with justice will still be ours. To carry this burden, we must be prepared to follow policies, private and public, that will keep our economy strong and vigorous.

Statistical Information

In an economic and social system organized around the principle of shared responsibility, a need of a technical order arises, namely, to make reliable statistics and other information broadly available in order to facilitate private and governmental decision-making, forecasting, and action. The variety of our economic and social life and the very pace of change require constant re-examination, expansion, and revision of the body of statistical and nonstatistical information designed to meet current and anticipated needs. Consistently with the objectives of the Employment Act, the Council of Economic Advisers has, in statistical appendixes to the *Economic Report of the President* and in *Economic Indicators,* facilitated wider access to needed economic data. The Executive Branch in general, and also the Congress, have participated in numerous undertakings to extend, diversify, and renovate the Federal contribution to the supply of published statistics and basic reports. Further improvements that will be needed include strengthening the national economic accounts, particularly the development of better estimates in terms of constant dollars; achieving more comprehensive coverage, as well as speedier collection of certain key data in the balance of payments; increasing the number of weekly series, so important to the appraisal of economic conditions and outlook at critical points in the business cycle; providing better information on inventories, the importance of which was dramatically illustrated during the steel strike of 1959 and its aftermath; enlarging available information on new orders, businessmen's and consumers' intentions, and other indicators useful in appraising the economic outlook; and expanding the supply of regional and area information to facilitate the planning and administration of private and public activities.

To a considerable extent, the Federal policies needed to help achieve sound and rapid economic growth can be applied administratively and require no legislative action by the Congress. However, there are important matters on which action is needed.

First, total funds appropriated by the next Congress for the fiscal year 1962 should be held within the limits of expected revenues. The budget presented to the Congress conforms to this standard and at the same time makes adequate provision for needed programs. It provides for an increase of $1.5 billion for major national security programs, and an additional $200 million for economic and financial assistance under the mutual security programs. It also provides for substantial increases in research and development activity and in other programs that have a significant bearing on the welfare of our citizens and on the rate and stability of economic growth: the development of natural resources, assistance to areas of high and persistent unemployment, the improvement of health and housing, and medical care for elderly persons.

Second, the budget for fiscal 1962 makes certain suggestions for revenues to cover these expenditures. It is recommended there that the present tax rates on corporation income, and the excise taxes scheduled for reduction or termination on July 1, 1961, be extended for another year. Unless these tax rates are extended, Federal Government revenues in the fiscal year 1962 will be $2.6 billion less than estimated and $3.7 billion less on a full year basis.

To obtain additional revenues in the coming fiscal year and later years, it is proposed that measures be enacted to charge users for special benefits which they derive from particular Government activities. Thus, the highway fuel tax should be raised to 4½ cents per gallon to provide funds in the Highway Trust Fund sufficient for construction of the interstate highway system on schedule; and the action taken by the Congress in 1959, which would divert funds from the general fund of the Treasury to build this road system, should be rescinded.

It is also recommended that Congress raise the excise tax rate on aviation gasoline from 2 cents to 4½ cents per gallon, impose the same tax on jet fuels, and retain the receipts from these taxes in the general fund to help defray the cost of the Federal airways system.

The request for a rate increase which will put the postal system on a self-supporting basis, apart from specified public services, is renewed. It is unreasonable that the system should operate at a deficit of nearly $900 million a year. Those who use postal services should pay prices sufficient to avoid deficits on this scale.

Third, the request is again made that the Congress give the Secretary of the Treasury authority to raise funds in the long-term capital market when, in his judgment, this is in the public interest, even if the cost of the funds is above 4¼ percent. Some long-term borrowing may be possible under current conditions without lifting this interest-rate ceiling, but the ceiling remains an important impediment to the Treasury's flexibility in achieving significant debt lengthening.

Fourth, the request for legislation to enable the Federal Government to assist areas that experience high and persistent unemployment is again repeated. The Administration's proposal is drafted to meet the standards described earlier in this chapter. Eligibility requirements for assistance under the proposed new program would direct funds to localities of greatest need and avoid spreading available Federal funds too thinly over a larger number of areas.

Fifth, it is again urged that steps be taken to promote long-term agricultural adjustment and to make effective use of accumulated agricultural surpluses. Specifically, the price support laws should be modified to reflect unit cost reductions resulting from increasing technological efficiency on commercial farms and thereby reduce budget expenditures for the stabilization of farm prices and support of farm income. Energetic administration of the Rural Development Program is the most promising means for assisting readjustment of that part of the farm population which has neither sufficient productive farm resources nor adequate employment opportunities off the farm. Maximum efforts should also be made to use more of our accrued agricultural surpluses in the Food-for-Peace Program.

Sixth, Congress failed last year to pass legislation to supplement the Federal Government's established programs for assisting education by aiding States and local communities and institutions of higher education to provide needed educational facilities. Legislative proposals which constitute a sound approach to this problem were put before the last Congress by the Administration; they are again recommended for favorable consideration.

Seventh, as proposed in earlier Economic Reports, the Congress should enact legislation to extend coverage of the unemployment compensation system to about 3 million additional workers, most of whom are employed in firms having fewer than four employees. With appropriate action by the States to raise the level and to increase the duration of benefits, this legislation would make the system more effective in helping to stabilize our economy during periods of rising unemployment and in alleviating personal hardship. The States are again urged to increase benefits to make the great majority of covered workers eligible for payments equal to at least half their regular earnings, and to increase the maximum duration of benefits to 26 weeks a year for all eligible workers who remain unemployed that long. Under our Federal-State system, primary responsibility for the level and duration of benefits rests with the States; however, in periods of especially high rates of unemployment that have been prolonged, the Congress should give consideration to a program which would temporarily supplement regular benefits in some such manner as was done with good effect in 1958.

Eighth, to enhance the progress being made for equalizing economic opportunity for all citizens, the Congress is again urged to establish a statutory commission on equal job opportunities under Government contracts and to enact legislation for carrying out the proposal of equal pay for equal work without discrimination because of sex.

Ninth, it is again recommended that the coverage of the Fair Labor Standards Act be extended to several million workers not now receiving its protection, and that a moderate adjustment be made in the minimum wage provided in the Act.

Tenth, the program under which Mexican workers are brought into the United States for agricultural work terminates at the end of 1961, unless extended. Legislation to extend this program should include improvement of the present law's provisions to ensure that employment of Mexican agricultural labor will not adversely affect the wages and employment opportunities of our own farm workers.

Eleventh, the Congress is also urged to remedy the serious defects in the legislation enacted in 1958 to protect the interests of the Nation's working men and women in private pension and welfare plans; and to revise the outmoded provisions of the 8-hour laws applying to Federal and certain federally assisted construction projects.

Twelfth, the last Congress enacted a program of Federal assistance for medical care for older persons under the regular old age assistance program and a new program of medical assistance for needy older people who are not recipients of public assistance. This voluntary program under Federal-State-local auspices is sound in principle. However, under the law enacted, many older people will not be able to obtain needed protection to cover major hospital and medical costs incurred because of serious illness. It is recommended that the Congress give further consideration to the recommendations made last spring by the Administration.

Thirteenth, existing programs for housing and community development are no longer experimental, and their successful operation in future years will be enhanced by the repeal of statutory termination dates and the removal of limitations on authorization amounts that can more properly be regulated through the normal appropriation process. Similarly, statutory maximum permissive interest rates should either be eliminated or adjusted to levels that will not bring about a restriction from time to time in the flow of investment funds. Permanency and flexibility in the basic housing programs will permit communities and industry to plan and regulate future activity without the burden of depending on, and adjusting to, the provisions of annual legislative enactments. To this end, the present authorization limitations should be removed on the amount of mortgages that can be insured by the Federal Housing Administration; similarly, legislative limits on grants for urban renewal projects should be removed and permanent authority for annual appropriations substituted. Also, the program to insure loans on home improvements should be made permanent. Present ceilings on interest rates should be eliminated or substantially raised for loans made or guaranteed by the Veterans Administration and for mortgages insured by the Federal Housing Administration on rental housing, especially housing for the elderly, and on family housing built for occupancy by members of the armed services.

Fourteenth, suggestions made in previous years for amendment of the antitrust laws, to improve the competitive quality of our economy, are repeated: (1) Firms of significant size engaged in interstate commerce and proposing to merge should be required to notify the antitrust agencies of their intention. (2) The Federal Trade Commission should be given authority to seek a preliminary injunction in the case of mergers likely to violate the antitrust laws. (3) The Attorney General should be given the power to issue civil investigative demands for the necessary facts when civil procedures are contemplated in antitrust cases. This last recommendation, which passed the Senate in the 86th Congress, would simplify and greatly speed up all such proceedings.

Finally, the recommendation that the Congress amend the Employment Act of 1946 to make reasonable price stability an explicit goal of national economic policy is renewed. As pointed out in the Economic Report of January 1960, this goal already appears to be implied in the declared objectives of the Act, but an amendment such as the one proposed would increase public awareness of the price stability problem and strengthen the Government's hand in pursuing effective policies to help prevent inflation. The proposed amendment is limited to a change in the language of the Act's declaration of policy and would accomplish its aim without placing restrictions on the effective operation of economic markets.

These proposals, like others placed before the Congress by the Administration, have been designed to promote the sound growth of our economy on the principles set forth in this Economic Report. They indicate routes along which we may move ahead confidently within our system of shared responsibility, in a manner that fosters private competitive enterprise and recognizes the obligations of State and local government, to achieve the purposes proclaimed in the Employment Act.