Chapter 1

Toward Full Recovery

PART I: OBJECTIVES, PROGRESS, AND PROSPECTS

THE U.S. ECONOMY made substantial advances in 1961 toward the goals of the Employment Act: "maximum employment, production, and purchasing power." Total production rose to a record rate of $542 billion a year in the fourth quarter, $41 billion above the level at the beginning of the year. Unemployment, which had been close to 7 percent of the labor force ever since December 1960, fell sharply toward the end of 1961; the rate was 6.1 percent in December. The annual rate of income, after taxes, of the American people rose from $1,940 per capita in the first quarter to $2,032 per capita in the last quarter of 1961. These gains in disposable income were almost entirely real gains in purchasing power. Prices were virtually stable during the year; the consumer index rose only 0.6 percent between December 1960 and November 1961. As the year ended, the economy was advancing vigorously.

Government fiscal and monetary policies contributed strongly to the favorable economic developments of the past year. Although the downswing probably would have ended early in 1961 in any case, the impressive pace of the economic expansion must be attributed in large measure to government actions. A summary of the Administration's program in 1961 to promote economic recovery is given in the Appendix to this chapter.

In spite of the significant gains of 1961, the economy at the turn of the year still fell short of the standards set forth in the Employment Act. Too many persons "able, willing, and seeking to work" were unable to find "useful employment opportunities." Even at record levels, national production had not yet reached its potential at full employment; and the purchasing power of the American people—the command over goods and services represented by their incomes—was still too low.

The prospect for 1962 is a continuation of the favorable trend of 1961. Whether the current expansion is sufficiently strong and durable to carry the economy to "maximum employment, production, and purchasing power", no one can now foretell with certainty. Current and proposed government actions will continue to give strong support to economic expansion. If these are coupled with continued strength in the private economy, the current expansion would reduce unemployment to 4 percent of the labor force by mid-1963. But, given the inevitable uncertainties, government policy must be alert and flexible, ready to promote the achievement of full recovery within the coming fiscal year and to counteract developments which might threaten its attainment. The President has made important proposals to increase the effectiveness and flexibility of government fiscal policy; these are discussed at length in Part II of this chapter.

Part I of this chapter discusses, first, the current implications of the objectives of the Employment Act: "maximum employment" as a guide to the fiscal and monetary policies of Government and to other public and private policies of equal ultimate importance; and the potential production and purchasing power of the American economy at levels of employment which full recovery can achieve. Next, it describes the progress of the economy in 1961 toward these objectives and the outlook for continued advance in 1962. Part II of the chapter discusses government policies for full recovery and maximum employment, with special emphasis on the Administration's policies in 1961 and its programs under way or proposed for the coming year.

The Objective of Maximum Employment

Reasons for Concern over Unemployment

The great depression led this Nation, and most other nations of the free world, to assume national responsibility for the human tragedy and economic waste of involuntary unemployment. Unemployment had previously been regarded as almost solely the personal responsibility of the individual; now it came to be acknowledged as a charge on the conscience of the Nation. The mass unemployment of the 1930's led to new understanding: that to be unemployed is not to be unemployable; that job opportunities for individual workers depend on national economic circumstances beyond their control.

There are three principal reasons why involuntary unemployment is a national concern: (1) the human obligation to prevent and to relieve economic distress, (2) the basic principle of a free economy that an individual should be able to choose freely how to use his time, whether to work for pay or not, and (3) the economic waste of leaving productive resources idle.

Preventing economic distress. First, a wealthy nation cannot in good conscience permit its citizens to be inadequately nourished, clothed, or housed; its sick to be denied medical care; or its young to be deprived of schooling. Unemployment insurance and public assistance are recognitions of this social obligation. But they are not substitutes for the opportunity to earn income from useful employment. For the breadwinner and his family, unemployment means a reduction in living standards. Only about three-fifths of the unemployed in 1961 were receiving unemployment insurance benefits. Even those who were insured generally found weekly benefits a pale shadow of their lost wages. When the unemployment insurance program was inaugurated in the late 1930's, the goal was to provide benefits equal to about half of previous earnings. As Table 1 indicates, benefits now do not meet this standard. The Administration has proposed permanent legislation to strengthen the unemployment insurance system in this and other respects.

TABLE 1.—*Weekly earnings in selected industries, and unemployment insurance benefits, 1961*

Item	Weekly average, 1961
Unemployment insurance benefits, all industries [1]	$33.80
Weekly earnings, selected industries: [2]	
Retail trade	64.01
Manufacturing	92.34
Telephone communication	92.75
Wholesale trade	93.32
Bituminous coal mining	112.10
Class I railroads	112.41
Contract construction	117.66

[1] For State programs only; see Table B–23.
[2] Gross earnings for production workers or nonsupervisory employees; see Table B–27.

Source: Department of Labor.

For all too many, unemployment has not been simply an uncomfortable interlude between jobs but a catastrophe of long duration; almost one-third of those unemployed in December 1961 had been out of work for 15 or more weeks and one-sixth had been unemployed for at least 27 weeks. Family savings vanish when unemployment is prolonged.

Unemployment is not a perfect measure of the incidence of economic distress. Failure to find work does not entail poverty for some unemployed persons: women whose husbands have good jobs, young people who can fall back on well-to-do parents, older people who have assured livelihoods from property incomes or annuities, people who earn an adequate annual income from work at a seasonal occupation during part of a year. On the other hand, there are many causes of economic distress other than unemployment. Some persons, though employed, suffer from reduced and inadequate incomes resulting from failure to obtain more than part-time or occasional work, or to earn decent returns from long hours of self-employment on the farm or in the shop. Other individuals are not regarded as unemployed simply because, discouraged by a lack of suitable opportunities, they have abandoned the search for jobs. Included in this group are individuals with personal disabilities who can find jobs only when labor markets are tight.

Nevertheless, changes in unemployment are indicative of changes in the over-all magnitude of economic distress. The same conditions of general prosperity which lead to lower unemployment figures also lead to lower rates of involuntary part-time idleness, to better rewards from self-employment, and to more job opportunities for persons on the fringes of the labor force. While effective measures to provide adequate job opportunities will not solve all problems of economic distress, they will solve a substantial share of them. And without successful policy against general unemployment, other attacks on poverty and insecurity stand little chance of success.

Assuring free choice. The second reason for national concern over unemployment is the basic principle of a free economy, embodied in the Employment Act, that "useful employment opportunities" be afforded "for those able, willing, and seeking to work." A free society abhors forced idleness as well as forced labor. This principle does not apply a means or needs test for job-seekers. It acknowledges that mature individuals should be able to choose for themselves how they spend their time, as between gainful employment, housework, leisure, and education. Involuntary unemployment can destroy morale and freedom of choice whether or not the individual is in economic need. Americans want to work. Neither welfare programs nor personal means can erase the frustration of the individual who is forced to conclude that society does not need or want his contribution. The general preference for gainful work over unemployment, however well compensated, is demonstrated by the low levels of unemployment in areas with buoyant labor markets, in occupations with ample job opportunities, and in the population at large during years of prosperity.

Avoiding economic waste. Finally, excessive unemployment is a waste of productive resources. When these resources are left idle, the useful goods and services they could have produced are forever lost to the Nation. These losses would be enormously wasteful at any time. They are dangerous in a decade when the economy must not only meet compelling domestic needs but underwrite the defense of freedom throughout the world. In coupling maximum production and purchasing power with maximum employment, the Employment Act recognizes the losses of national output and real income associated with unemployment. An estimate of these losses in present circumstances is attempted below. Changes in the unemployment rate are roughly indicative of changes in the "gap" between realized and potential production. The same measures of policy which will lower unemployment will also raise national output closer to capacity to produce. The national economic losses associated with unemployment are, of course, quite independent of the individual circumstances of the unemployed. If housewives, elderly persons, and teen-agers on vacation from school are eager and able to produce useful goods and services, it is foolish and wasteful for the Nation to forego their contributions.

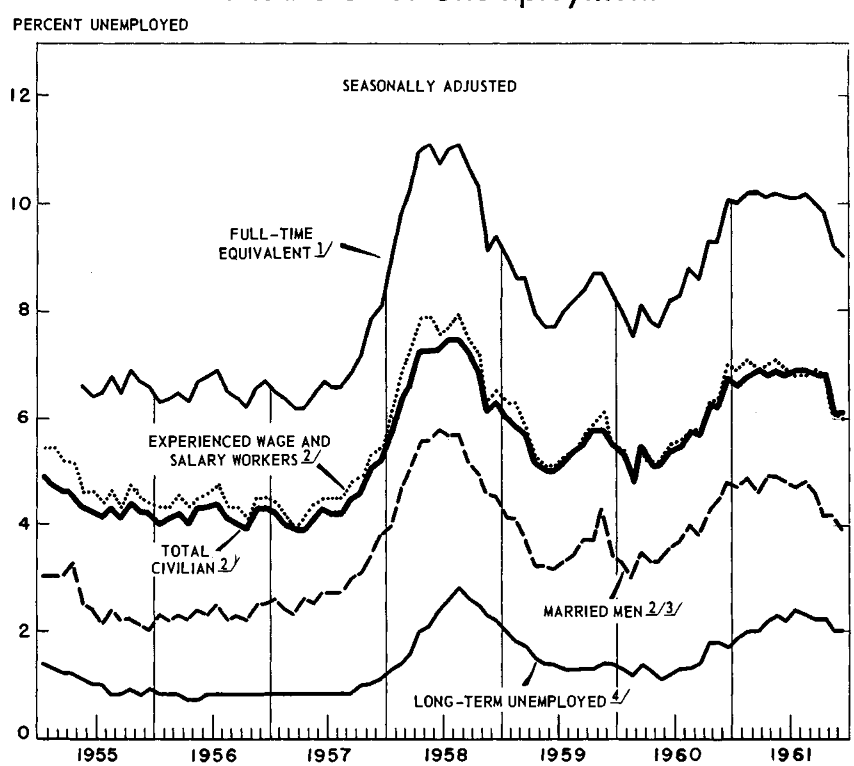
Measures of unemployment. The global measure of unemployment as a percentage of the civilian labor force, provided monthly by the Current Population Survey and published by the Bureau of Labor Statistics, is the best single measure of the economic distress, the frustration of free choice, and the economic waste associated with unemployment. But there are other measures of independent interest. Four of these measures, along with the global rate, are shown in Chart 1:

(1) The unemployment rate among *experienced wage and salary workers*—those who have already held at least one job. This measure

excludes the self-employed and new entrants to the labor force. (2) The unemployment rate among *married men living with their wives.* This measure relates to individuals whose commitment to the labor force is permanent and necessary to the support of their families. It does not cover all individuals with such a commitment, and conceptually it is inappropriate both as a measure of economic waste and as an indicator of involuntary unemployment among persons "able, willing, and seeking to work." (3) A *full-time equivalent* measure which (a) adds to the wholly unemployed the full-time equivalent of work lost by involuntary part-time employment and (b) subtracts the self-employed from both the labor force and civilian employment on the grounds that they are not subject to the risk of unemployment. This concept has merit as a measure of economic waste and of imbalance in markets for hired labor. (4) The number of

CHART 1

Measures of Unemployment



1/UNEMPLOYED PLUS FULL-TIME EQUIVALENT OF PART-TIME EMPLOYED AS PERCENT OF CIVILIAN LABOR FORCE. EXCLUDES SELF-EMPLOYED AND UNPAID FAMILY WORKERS.

2/PERCENT OF CIVILIAN LABOR FORCE IN GROUP.

3/MARRIED MEN LIVING WITH THEIR WIVES.

4/PERSONS UNEMPLOYED 15 WEEKS OR MORE AS PERCENT OF CIVILIAN LABOR FORCE.

SOURCES: DEPARTMENT OF LABOR AND COUNCIL OF ECONOMIC ADVISERS.

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long-term unemployed, those who have been jobless for more than 15 weeks, as a percentage of the labor force. This rate is an important measure of the financial and social distress caused by the concentration of prolonged unemployment on a small fraction of the labor force.

The differences among these measures reveal more clearly than any single measure the anatomy of unemployment. But they show no systematic tendency to widen or narrow. If due allowance is made for volatility in month-to-month movements all five measures tell the same story about changes in economic conditions.

Full Employment as the Objective of Stabilization Policy

The goal of the Employment Act is "maximum employment," or—to put it the other way round—minimum unemployment. Ideally, all persons able, willing, and seeking to work should be continuously employed. Involuntary unemployment is an individual and social evil. No one would prefer for its own sake a higher rate of unemployment to a lower one. But zero unemployment is unattainable. A more meaningful figure is needed to give content to the realistic and forceful declaration of policy in the Employment Act. A feasible interim goal must reflect a balancing of employment and production objectives with other considerations of national policy, within the limits set by the existing characteristics of the economy. Such a goal is set forth in the discussion which follows. We must not forget, however, that any practical unemployment goal is only a temporary compromise, and its attainment must never be an occasion for relaxation, but rather an incentive to search out ways to achieve a still lower rate.

The partial conflict which exists between minimum unemployment and certain other national objectives—and which imposes the necessity of striking a balance between them—results mainly from the fact that these other objectives are served by stability of the general price level. Given the existing structure of the economy and the nature of the processes by which prices and wages are determined, a serious attempt to push unemployment close to zero would produce a high rate of price inflation. The result would be a weakening of the competitive position of U.S. products in world markets, an arbitrary redistribution of real income and wealth, and a threat of even more serious consequences if expectations of further inflation should become dominant.

Happily, however, the conflict between the goals served by price stability and the goal of minimum unemployment is only partial. Stabilization policy—policy to influence the level of aggregate demand—can strike a balance between them which largely avoids the consequences of a failure in either direction. Furthermore, the degree of conflict can be diminished by private and public policies which improve the functioning of labor and product markets.

There are various possible causes of unemployment, on the one hand, and of inflationary pressure, on the other. These causes may be grouped into (1) those related to aggregate demand and (2) those related to the structure and functioning of markets. It is necessary to distinguish carefully between these two groups of causes in setting an appropriate target for stabilization policy.

The relation of aggregate demand and of structural causes to unemployment may be briefly described as follows:

(1) The total effective demand for goods and services—by consumers, businesses, and governments—may be insufficient to employ all the persons seeking work at existing wage rates.

(2) Workers may be idle while vacancies are unfilled. This may arise because the workers live too far away from the available jobs, are not qualified for them, or simply are unaware of their existence. In a dynamic economy, there will always be workers between jobs, some seeking new positions out of preference, some displaced by economic and technological change. New entrants to the labor force will similarly be unemployed while locating jobs suitable to their qualifications and preferences. The length of "frictional" unemployment for any one worker, and the size of the pool of frictionally unemployed, depend on how smoothly the labor market functions, how well the skills, experience, and qualifications of workers match the specifications of available jobs, how ready workers are to change residence and occupation, how adequate are facilities for training and retraining, and how rapidly displacements resulting from economic change are occurring. Structural unemployment may be regarded as an extreme form of frictional unemployment. It occurs when inability or failure to make the necessary adjustments concentrates unemployment of long duration on displaced workers in particular areas and occupations, while elsewhere jobs are seeking workers of quite different qualifications.

Similarly, aggregate demand and the structure of markets are related to the price level, as follows:

(1) Inflation may result from excessive aggregate demand. Demands for goods and services by consumers, businesses, and governments may add to a total which exceeds the amount that the economy can supply. Prices will be bid up in all markets, and, as business firms try to expand output in order to seize the profit opportunities presented, increases in wages and in costs of materials will follow. The resulting rise in incomes will reinforce and renew the process. In less extreme circumstances, aggregate demand may press hard upon, but not exceed, the economy's productive capacity. Increases in prices and wages may occur nevertheless, reflecting the need to obtain additional output by using labor and capital more intensively—by making greater use of overtime labor, by attracting workers from great distances, by making employment attractive to persons formerly not in the labor force, and by making use of obsolescent capacity and inefficient production techniques.

(2) Upward pressure on prices may originate in those sectors of the economy where competitive forces are weak and large corporations and

unions have a considerable degree of discretion in setting prices and wages. (This discretion, and the public interest in its responsible exercise, are discussed in Chapter 4.) There are two ways in which wage and price decisions in these sectors may put upward pressure on the general price level. First, prices may be increased when demand is not strong in the aggregate or even in the specific industries involved. Because the prices of these industries affect costs elsewhere, increases in their prices tend to spread throughout the economy. Second, prices in these sectors may remain constant in the face of declining demand, although they rise in times of increasing demand. The result in the long run is an upward drift in prices in these industries, which again tends to be transmitted to the whole economy.

Expansion of aggregate demand is clearly the specific remedy for unemployment caused by a deficiency of aggregate demand. Excessive aggregate demand, however, is a source of inflationary pressure. Consequently, the target for stabilization policy is to eliminate the unemployment which results from inadequate aggregate demand without creating a demand-induced inflation. A situation in which this is achieved can appropriately be described as one of "full employment," in the sense that further expansion of expenditure for goods and services, and for labor to produce them, would be met by only minor increases in employment and output, and by major increases in prices and wages. Correspondingly, expansion of demand beyond full employment levels would involve a major sacrifice of the objectives served by price stability, and only a minor gain with respect to the goal of maximum employment.

The selection of a particular target for stabilization policy does not commit policy to an unchangeable definition of the rate of unemployment corresponding to full employment. Circumstances may alter the responsiveness of the unemployment rate and the price level to the volume of aggregate demand. Current experience must therefore be the guide.

In the existing economic circumstances, an unemployment rate of about 4 percent is a reasonable and prudent full employment target for stabilization policy. If we move firmly to reduce the impact of structural unemployment, we will be able to move the unemployment target steadily from 4 percent to successively lower rates.

The recent history of the U.S. economy contains no evidence that labor and commodity markets are in general excessively "tight" at 4 percent unemployment. Neither does it suggest that stabilization policy alone could press unemployment significantly below 4 percent without creating substantial upward pressure on prices.

When unemployment was about 5 percent, as in 1959 before the steel strike and in the first half of 1960, the economy showed many independent symptoms of slack, notably the substantial underutilization of plant and equipment capacity. The wholesale price index fell at a rate of 0.2 percent a year in the 15 months April 1959–July 1960; and at the consumer level, prices of commodities other than food rose at a rate of only 0.6 percent.

The economy last experienced 4 percent unemployment in the period May 1955–August 1957, when the unemployment rate fluctuated between 3.9 percent and 4.4 percent (seasonally adjusted). During this period, prices and wages rose at a rate which impaired the competitiveness of some U.S. products in world markets. However, there is good reason to believe that upward pressures of this magnitude are not a permanent and systematic feature of our economy when it is operating in the neighborhood of 4 percent unemployment. The 1955–57 boom was concentrated in durable manufactured goods—notably automobiles (in 1955), machinery and equipment, and primary metals. The uneven nature of the expansion undoubtedly accentuated the wage and price pressures of those years. Moreover, the review of the present price outlook in Chapter 4 points to a recent strengthening in the forces making for price stability. The experience of 1955–57 is nevertheless sobering, and experience at higher levels of activity will be needed to indicate whether stabilization policy can now undertake a more ambitious assignment than 4 percent unemployment.

There is no precise unemployment rate at which expansion of aggregate demand suddenly ceases to affect employment and begins to affect solely the general price level. The distinction between aggregate demand effects and structural effects is a matter of degree, both for employment and for the general price level. Sufficiently high levels of aggregate demand can, and have in the past, cut deeply into frictional and structural unemployment. When vacancies are numerous, the time required to find an attractive job is reduced. When there are vacancies everywhere, no one needs to travel far to find a job. And when no applicant for a job meets its exact specifications, the specifications may well be adjusted. Similarly, the degree of inflationary pressure arising from discretionary price and wage setting is not independent of the general strength of demand. Presumably, this pressure could be entirely eliminated by sufficient weakness in aggregate demand if that were the sole objective of stabilization policy.

But while stabilization policy would not be an ineffective cure for either one or the other of these economic ailments, it would be an extremely expensive cure. On the one hand, attempting to reduce frictional and structural unemployment by a highly inflationary expansion of demand would court disaster in our balance of payments position. On the other hand, an attempt to restrict aggregate demand so severely as to eliminate all risk of an increase in the general price level might well involve keeping the economy far below full employment. This would mean sacrifice rather than achievement of both of the major goals that price stability serves: Equity would be sacrificed because the economy as a whole, and the unemployed in particular, would suffer as a result of the manner in which a few individuals and groups exercise their economic power. Eventually, the balance of payments would also be weakened: under conditions of prolonged unemployment and excess capacity, the investment needed to keep our exports competitive in quality and cost would be unlikely to occur.

The 4 percent interim goal refers to the global measure of unemployment as a percentage of the civilian labor force. An objective stated in terms of any of the other measures of unemployment discussed above would have the same implications for stabilization policy, for the various measures tell the same story with respect to the degree of over-all tightness in the economy. The particular numerical statement of the goal must, of course, change with the unemployment concept used. For example, 4 percent in terms of the global measure is roughly equivalent to a rate of 2¼ percent among married men living with their wives; the latter figure, though lower, is at least as serious as the former in its implications for the human consequences of unemployment. Corresponding figures for the other measures of unemployment are 4¼ percent among experienced wage and salary workers, 6¼ percent for the full-time equivalent concept, and, if the 4 percent global rate is long sustained, a two-thirds of one percent rate of long-term unemployment.

Unemployment of 4 percent is a modest goal, but it must be emphasized that it is a goal which should be achievable by stabilization policy alone. Other policy measures, referred to in the next section and discussed in detail in Part II of this chapter, will help to reduce the goal attainable in the future below the 4 percent figure. Meanwhile, the policies of business and labor, no less than those of Government, will in large measure determine whether the 4 percent figure can be achieved and perhaps bettered in the current recovery, without unacceptable inflationary pressures.

Full Employment and Structural Unemployment

One way to raise the attainable level of full employment is to reduce frictional and structural unemployment by improving the mobility of labor and the efficiency of labor markets. The amount of frictional and structural unemployment varies from country to country and from time to time within any one country. It has sometimes been suggested that, though a 4-percent unemployment rate was once achievable in the United States with adequate levels of demand, it is no longer a feasible goal because of increasing technological displacement of workers, rapid obsolescence of skills, intractable pockets of depression, and greater numbers of young people swelling the labor force. Careful analyses at the Council and elsewhere—notably in a recent report by the staff of the Joint Economic Committee of the Congress—lend no support to the view that frictional and structural unemployment is a rising proportion of the labor force. It would be wholly wrong, however, to conclude that improvement in the structure of the labor market is not both possible and of high importance.

The displacement of labor through changes in technology, consumer tastes, and the geographic distribution of industry is an inevitable part of the growth of a free and progressive economy. But the level of unemployment corresponding to any given pace of progress depends on the smoothness with which markets function. The size of the pool of unemployed workers, like the size of a pool of water, is determined jointly by the flow into it and the flow out of it. The flow into it depends on the rate at which workers leave jobs or are displaced and on the rate at which new workers enter the labor force without jobs. The flow out depends on the speed with which the unemployed can transfer to jobs vacated by retirement, and to other skills, other industries, and other areas where jobs are available in expanding sectors of the economy.

Economic policy can reduce the size of the pool by providing opportunities for vocational training and retraining, by improving the flow of information about job opportunities, by facilitating the relocation of displaced workers, by acting to reduce and eliminate discriminatory hiring practices, and by assisting in the rehabilitation of depressed areas through the renovation of public facilities and the attraction of viable industry. Administration policies and proposals to attain these ends are discussed in Part II of the present chapter.

The benefits to the United States from the pursuit of such policies are great. In their absence, many of our citizens become, in a real sense, victims of progress; they are condemned to prolonged periods of unemployment which benefit no one and inflict an unjust penalty on an arbitrarily selected few. In their absence, we can expect resistance to technological progress from those who would be harmed by it without prospect of reward.

The returns from such policies do not come instantaneously. For that reason, we should undertake them now, even while unemployment and excess capacity are widespread. There is still time to reap the benefits of the reduction of structural unemployment during the current recovery. But these policies are no substitute for an adequate level of demand. Experience tells us that the pull of expanding job opportunities is a vitally necessary condition for the success of policies to assure a better functioning labor market.

Full Production

Productive Potential

The Economic Report is required by the Employment Act to set forth "the levels of employment, production, and purchasing power obtaining in the United States and such levels needed to carry out the policy" of the Act. In accordance with the obligation to set forth the levels of production needed to carry out the objectives of the Act, the Council has made the following estimates: (1) In the first quarter of 1961, a gap of $51 billion (1961 prices, annual rate) existed between actual gross national product (GNP) and the output obtainable at full employment. (2) By the last quarter of the year, recovery had narrowed this gap to about $28 billion.

(3) For 1961 as a whole, production averaged $40 billion below potential.
(4) The production potential for the year 1962 is estimated at $580 billion (in 1961 prices).

Estimates of this kind cannot, of course, be precise. But they are essential in order to specify, within reasonable margins of error, a current measure of "maximum production" linked to "maximum employment." They indicate clearly that this Nation can achieve a huge bonus of output and income by making full use of its resources.

The level of unemployment is a barometer of economic waste. Each percentage point of progress toward 4 percent in the unemployment rate has meant a gain of roughly 3 percent in total output in postwar periods of expansion.

The sources of potential gains in output accompanying full employment are given in Table 2, which shows the gain in output that each source could

TABLE 2.—*Allocation of estimated $40 billion gap between potential and actual gross nationa product, 1961*

[Billions of dollars]

Source	Associated increment of output
Total	40
Lower unemployment	15
Larger labor force in response to greater demand	4
Longer hours of work per man associated with higher utilization	5
Greater productivity per man-hour associated with higher utilization	16

Source: Council of Economic Advisers.

have contributed if aggregate demand in 1961 had been sufficient to reduce unemployment to 4 percent of the labor force. The figures incorporate evidence from postwar relationships among labor input, productivity, and output. An unemployment rate of 4.0 percent instead of 6.7 percent for 1961 would in itself have increased the number of jobs by 3 percent of actual employment. But it would have raised production by much more, about 8 percent. The reason that improved employment conditions yield magnified gains in output is that, in addition to putting the jobless back to work, they have a number of other favorable effects on output.

Higher output would have accompanied lower unemployment in the following manner:

(1) Actual unemployment in 1961 was 4.8 million persons. Given the actual 1961 labor force of 71.6 million persons, 2 million of the unemployed would have been at work at an unemployment rate of 4 percent.

(2) At full employment, the labor force would probably have been considerably higher in 1961 and production would have been correspondingly increased. Participation in the labor force is encouraged by greater availability of job opportunities. In recent years of slack activity, the actual

labor force has been abnormally low relative to the number of persons of working age.

(3) Furthermore, a brisker pace of economic activity is accompanied by a higher average number of hours a week worked by those employed. Part-time jobs are converted into full-time employment, and overtime work increases in private nonfarm industry.

(4) Because of these three factors—less unemployment, larger labor force, and longer hours of work—labor input at full employment in 1961 would have exceeded actual labor input by more than 4½ percent, the equivalent of 7 billion man-hours. The added man-hours could have increased production by $24 billion, at existing rates of productivity.

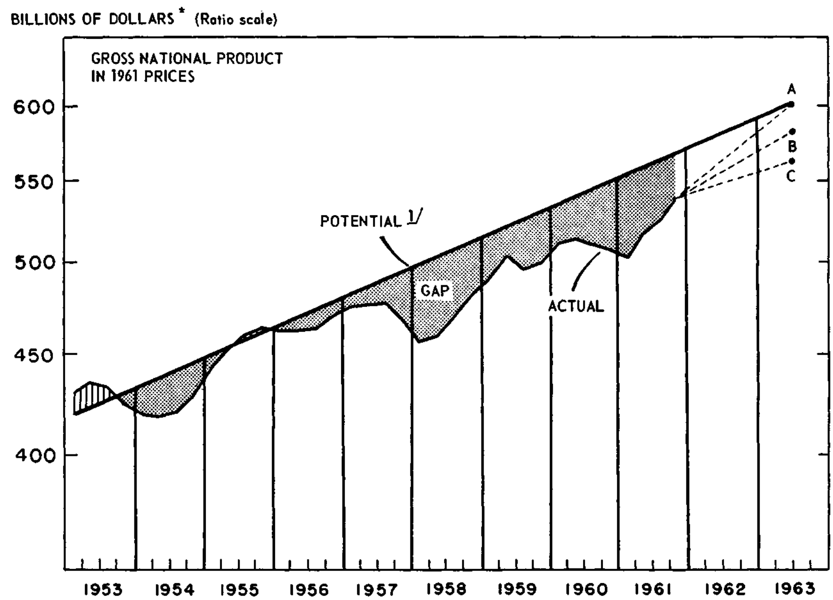
(5) The higher productivity that accompanies fuller use of resources would have meant still more output. In recessions, business firms cannot cut back their labor force as fast as their output falls. Clerical help and sales and supervisory personnel are essentially "overhead." Moreover, while firms can and do lay off production workers, they do so only with reluctance, preferring both to maintain morale and to avoid the expense of hiring and training new labor when business activity recovers. Recessions thus produce on-the-job underemployment, which is reflected in depressed levels of productivity. In movements toward full employment, recession losses in productivity are regained. At full employment, productivity in 1961 would, according to past evidence, have been 2 to 4 percent higher than it actually was. This gain is equivalent to a $10 to $20 billion increment of GNP. The table shows a $16 billion figure, near the middle of the range, bringing the total estimated gain from all sources to $40 billion.

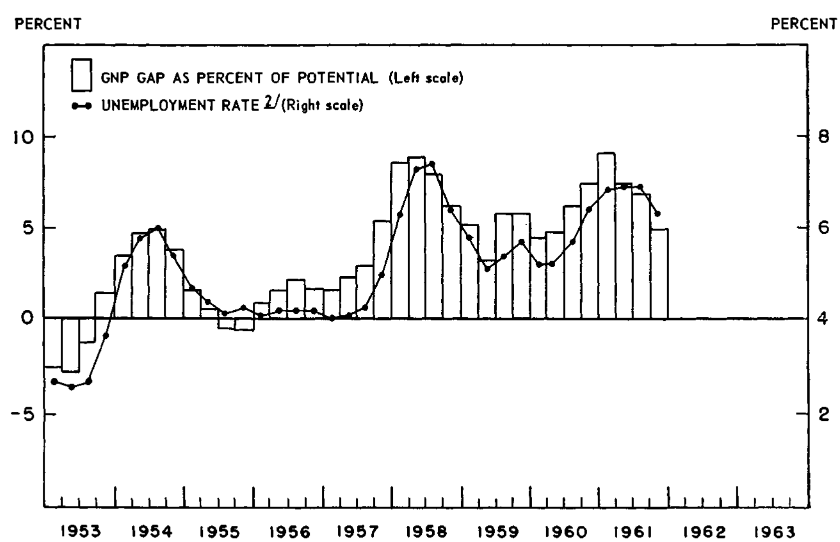
These calculations receive further support from an alternative approach. Evidence on the relationship between output and unemployment suggests that actual GNP in mid-1955, when the unemployment rate was close to 4 percent, was equal to potential output. The trend rate of growth of GNP, adjusted for changes in unemployment levels, has averaged about 3½ percent in the post-Korean period. Thus the path of potential GNP can be represented by a 3½ percent trend from actual GNP in mid-1955 (Chart 2). The 1961 value of the trend exceeds actual output by $40 billion, which is equal to the sum of the components described above.

The distance between potential and actual GNP was narrowed by $23 billion from the first to last quarter of 1961, as output increased by $37 billion (1961 prices). Among the four factors listed above, the first two, reduction in unemployment and increase in the labor force, contributed less to the gain in production than past experience would have suggested. Of the other two factors, hours of work in nonfarm industries expanded roughly in accord with past behavior; but man-hour productivity achieved an exceptional gain, probably above 6 percent in the three quarters of expansion. As a result, the 7½ percent increase in total production was achieved with a very small increase in employment: nonfarm employment increased by about 1½ percent, but this rise was partially offset by a decline

CHART 2

Gross National Product, Actual and Potential, and Unemployment Rate





* SEASONALLY ADJUSTED ANNUAL RATES.

1/ 3½% TREND LINE THROUGH MIDDLE OF 1955.

2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE; SEASONALLY ADJUSTED.

NOTE: A, B, AND C REPRESENT GNP IN MIDDLE OF 1963 ASSUMING UNEMPLOYMENT RATE OF 4%, 5%, AND 6%, RESPECTIVELY.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

in agricultural employment. It is primarily because latent productivity was exploited so effectively that unemployment remained high.

The estimated gap of $28 billion, or 5 percent, between potential and actual output in the fourth quarter of 1961 reflected principally a shortfall in persons employed. At the end of the year, there was room for a slight further rise in average weekly hours worked. The impressive gains in productivity during the year brought output per man-hour at the year-end close to the full employment level indicated by past experience. Nevertheless, further gains in productivity as a result of fuller utilization of existing capacity may still be ahead. In any case, further additions to output during the coming year are expected to require larger increases in employment than in 1961.

The unemployment rate will fall in the coming year if, and only if, production continues to rise in relation to the economy's potential. The prospects for 1962 are discussed later in this chapter.

A full-utilization economy in 1963 would provide nearly 72 million civilian jobs and generate an estimated $600 billion GNP (1961 prices). These figures—5 million more jobs and nearly $80 billion more output than 1961 levels—suggest the magnitude of the opportunity and challenge we face. To help visualize this challenge more concretely, Table 3 presents an illustrative pattern of employment, productivity, and output for the full year 1963 consistent with 4 percent unemployment.

TABLE 3.—*Employment, output, and productivity, 1961 actual and 1963 illustrative*

Sector	Employment (millions of persons)		Output (billions of dollars, 1961 prices)		Output per employed person (dollars)	
	1961 actual	1963 illustrative [1]	1961 actual [2]	1963 illustrative [1]	1961 actual [2]	1963 illustrative [1]
Total economy [3]	69.4	74.3	521.2	600	7,500	8,100
Agricultural	5.5	5.2	21.0	21	3,800	4,000
Private nonagricultural	54.2	58.8	449.4	525	8,300	8,900
General government [3]	9.7	10.3	50.8	54		
Addendum:						
Civilian employment	66.8	71.6				
Unemployment	4.8	3.0				

[1] Illustrative pattern projected at 4 percent unemployment; by Council of Economic Advisers.
[2] Estimates by Council of Economic Advisers.
[3] Includes military.

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

Plant and Equipment Capacity

Periods of slack and recession in economic activity lead to idle machines as well as idle men. Only once since 1949, at the trough of the 1958 recession, was there more excess plant and equipment capacity in U.S. industry than at the start of 1961. While increases in output during the past year have led to fuller use of capital facilities, 1962 begins with considerable room for expanded output from existing plant and equipment, enough room to permit achievement of the full employment goal. This excess capacity is available to be tapped on demand. It is easier to expand employment at stable prices when tools are already available for new job-holders. Otherwise, capital might act as a bottleneck, obstructing the flow of increased demand for goods into improved employment opportunities for labor.

While unused capital is a reserve source of supply, it dampens the vigor of demand. Although much of investment is undertaken primarily for replacement and modernization, investment for expansion of capacity is important to aggregate demand as well as to economic growth. Inducements to expand plant and equipment are stronger when present facilities are fully utilized. The rate at which existing capacity is utilized also influences the ability of firms to finance investment out of retained earnings. Unused tools are a drag on profits. They yield no return and they impose overhead costs for maintenance and depreciation.

The reliability of measures of productive capacity and capital stock is severely limited by both conceptual and statistical difficulties. But an increasing amount of quantitative evidence is becoming available. Carefully used, it can be very helpful in arriving at the needed qualitative judgments about productive capacity. Two series of data on capital utilization from 1953 to date are presented in Chart 3. One measures the ratio of actual output to capacity output for all manufacturing industry. The other shows the output-capital ratio: the ratio of the value of total ouput to the value of the stock of plant and equipment, both expressed in 1954 prices, covering all private domestic business except residential housing. Although the two measures are derived by substantially different methods, they move together very closely, offering encouraging evidence of their general validity as measures of capital utilization.

A number of significant points are evident from the chart:

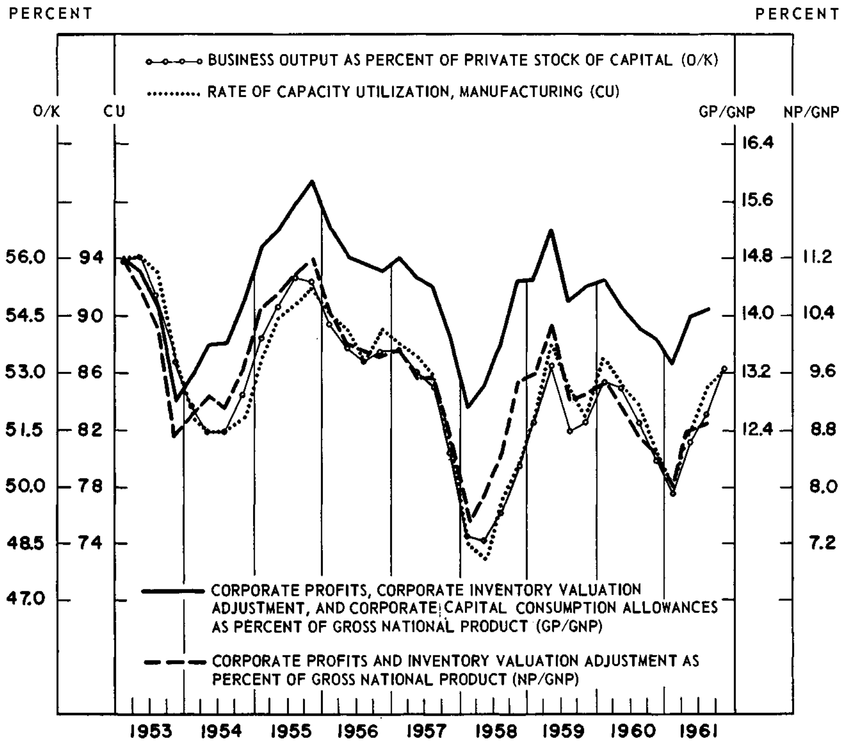
(1) Measures of capital utilization, like unemployment rates, indicate the persistence of slack in the economy over the past five years. Even during the expansion of 1959–60, operating rates and the ratios of output to the stock of capital remained considerably below their 1955–56 levels.

(2) Recessions are clearly marked by excess capacity in plant and equipment. Capital was most underutilized at the 1958 trough; the low point of early 1961 lies about midway between the 1958 rates and those of the 1954 recession. Because capacity grew slowly in 1958–61, excess capacity in early 1961 was smaller than in 1958 even though unemployment was just as large.

(3) Output gains must match the growth of plant and equipment capacity in order to maintain rates of capital utilization. Periods of slow advance in production, like 1956–57 and 1959–60, lead to declining rates of utilization.

CHART 3

Capacity Utilization and Corporate Profits



SOURCE: COUNCIL OF ECONOMIC ADVISERS (BASED ON DATA OF DEPARTMENT OF COMMERCE AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM).

(4) Considerable excess capacity remains in the economy despite the rapid rise of utilization rates during 1961. While there is no clear benchmark of full utilization of capital, the operating rates and output-capital ratios attained in late 1955 can serve as a reasonable indication. If GNP had been at its estimated potential level in the last quarter of 1961, capital utilization rates would have been approximately at the levels attained in late 1955. Existing excess capacity in plant and equipment is thus compatible with full employment of the labor force.

(5) Levels of capital utilization have a potent influence on corporate profits. The share of corporate profits in GNP moves closely with the measures of capital utilization, although it swings somewhat earlier. Corporate depreciation allowances have increased rapidly and "gross profits"—net profits and inventory valuation adjustment plus capital consumption allowances—have been maintained during the 1953–61 period. But net profits have declined as a fraction of GNP in recent years; the combination of unrelenting overheads and depressed levels of output can fully account

for this "squeeze." As corporate capacity is put to fuller use, profits benefit from larger margins as well as expanded sales.

Progress in 1961

The Situation at the Beginning of the Year

As 1961 began, economic activity was far below its full employment level, and production and income continued to contract through February. By most measures of the decline in economic activity, the 1960–61 recession was the mildest in the postwar period. But the peak reached in May 1960 had followed a year of very slow advance in output and ended the shortest expansion in the postwar period. At the 1960 peak, unemployment and excess capacity were higher than at any prior postwar peak. Unemployment rates were higher during the 1960–61 recession than during the slumps of 1948–49 and 1953–54; in this respect, the recession was almost as severe as that of 1957–58.

The rate of use of existing facilities in late 1959 and early 1960 was not conducive to substantial further increases in business fixed investment, nor were monetary conditions encouraging. Although there was a brief interlude in the first quarter of 1960 when investment demand rose sharply, this buoyancy was to a large extent a temporary aftermath of the steel strike of 1959. As orders, sales, and profits proved disappointing, investment in both fixed capital and inventories was cut back.

During this period, government fiscal programs gave little support to aggregate demand. Total Federal expenditures, on income-and-product account, showed little change between mid-1959 and mid-1960 as Federal purchases of goods and services actually declined. In January 1960, Federal social insurance taxes were increased by about $2 billion a year. Indeed, the sharp change in the relationship between Federal Government receipts and expenditures was perhaps the most important factor in choking off the recovery.

The recession followed the same pattern as previous postwar downswings. With activity weakening, purchases of goods were cut back throughout the private economy. Inventory investment, as usual, displayed the largest decline among major components of GNP (Table 4). The decline of inventories, as well as of other major categories of expenditure, was concentrated in durable goods. Correspondingly, a decline of 12 percent in durable goods manufacturing accounted for most of the fall in industrial production from May 1960 to February 1961. Unemployment, which had been 5.1 percent (seasonally adjusted) of the civilian labor force in May, rose to 6.8 percent in February.

Once the contraction began, it was certainly moderated, and perhaps shortened, by a rise in outlays at all levels of government. The automatic stabilizers in the Federal fiscal system contributed to the stability of personal consumption expenditure during the recession, as transfer payments rose

TABLE 4.—*Changes in output, income, and employment over the three quarters of the 1960–61 recession*

[Seasonally adjusted]

Item	Cyclical peak: Second quarter 1960	Cyclical trough: First quarter 1961	Change, peak to trough
	Billions of dollars, annual rates		
Output (1961 prices):			
Gross national product	514.2	502.9	−11.3
Personal consumption expenditures	333.9	331.7	−2.2
Gross private domestic investment:			
Fixed investment	69.5	64.2	−5.3
Residential nonfarm construction	21.2	19.4	−1.8
Other construction	19.9	20.6	.7
Producers' durable equipment	28.4	24.2	−4.2
Change in business inventories	5.4	−4.0	−9.4
Net exports of goods and services	3.0	5.3	2.3
Government purchases of goods and services	102.3	105.7	3.4
Federal	54.4	54.9	.5
State and local	47.9	50.8	2.9
Income (current prices):			
Disposable personal income	352.7	354.3	1.6
Corporate profits after taxes	23.3	20.0	−3.3
	Millions of persons		
Employment:			
Total civilian employment	67.0	66.8	−0.2
Employment in nonagricultural establishments	54.6	53.5	−1.1
Private	46.1	44.9	−1.2

NOTE.—Detail will not necessarily add to totals because of rounding.
See Tables B–2, B–11, B–15, B–19, and B–24.

Sources: Department of Commerce and Department of Labor.

by $3.0 billion and personal taxes fell by $0.7 billion (annual rates) to offset much of the fall in private wages and salaries resulting from lower employment.

Recovery During the Year

By the end of 1961, production and income had improved markedly, and most economic indicators had surpassed their 1960 peaks. In the final quarter of 1961, GNP, measured in constant prices, was 7½ percent higher than in the first quarter, and about 5 percent above the peak attained in the second quarter of 1960 (Tables 4 and 5). The only major category of expenditure that was lower than in the second quarter of 1960 was expenditure for producers' durable equipment. Industrial production in December exceeded its low point of February by 13 percent, and was 4 percent above the previous peak attained in January 1960.

The increase of $41 billion (current prices, annual rate) in GNP from the first to last quarters of 1961 distributed substantial gains in income widely through the economy. Personal income grew by $24 billion. Wage and salary disbursements expanded by $19 billion and accounted for

TABLE 5.—*Changes in output, income, and employment over three quarters of expansion, 1961*

[Seasonally adjusted]

Item	1961 First quarter (cyclical trough)	1961 Fourth quarter [1]	Change, trough to fourth quarter
	Billions of dollars, annual rates		
Output (1961 prices):			
Gross national product	502.9	540.2	37.3
Personal consumption expenditures	331.7	347.8	16.1
Gross private domestic investment:			
Fixed investment	64.2	71.4	7.2
Residential nonfarm construction	19.4	23.2	3.8
Other construction	20.6	20.2	-.4
Producers' durable equipment	24.2	28.0	3.8
Change in business inventories	-4.0	4.5	8.5
Net exports of goods and services	5.3	4.0	-1.3
Government purchases of goods and services	105.7	112.5	6.8
Federal	54.9	59.9	5.0
State and local	50.8	52.7	1.9
Income (current prices):			
Disposable personal income	354.3	375.6	21.3
Corporate profits after taxes	20.0	[2] 23.8	[2] 3.8
	Millions of persons		
Employment:			
Total civilian employment	66.8	66.9	0.1
Employment in nonagricultural establishments	53.5	54.5	1.0
Private	44.9	45.5	.6

[1] Preliminary estimates of output and income by Council of Economic Advisers.
[2] Third quarter data and change from first to third quarter.

NOTE.—Detail will not necessarily add to totals because of rounding.
Sources: Department of Commerce and Department of Labor (except as noted).

most of the gain in personal income. Incomes from dividends and business ownership also rose. Farm operators' net income from farming increased from $12.0 billion in 1960 to $13.1 billion in 1961, and net income per farm rose by nearly $350. Disposable personal income (after taxes) grew by $21 billion over the three quarters of expansion, adding $92 to average per capita spendable income.

The effect of rising output is strikingly shown in the $3.8 billion increase—nearly 20 percent—in the annual rate of corporate profits after taxes from the first to the third quarter. By all indications, corporate profits rose further in the fourth quarter and probably exceeded $50 billion before taxes and $25 billion after taxes.

Higher private incomes meant larger tax liabilities: Federal receipts in the income-and-product budget rose by about $10 billion (annual rate) in the three quarters of expansion, and the yield of State and local taxes grew by $3 billion.

The recovery was paced by a prompt and sharp reversal in inventory investment, the volatile inventories of manufacturers of durable goods accounting for a major share of the movement. During recessions, output falls below final sales as some orders are filled out of excessive stocks. The end of inventory liquidation in itself raises production to the level of sales. And rising sales and orders in a period of economic recovery encourage the accumulation of stocks, creating further gains in production. In 1961, this characteristic switch from liquidation to accumulation occurred very promptly, only one month after the trough in over-all activity, and was a major factor in the $15 billion expansion of GNP in the second quarter. Incentives for restocking did not arise wholly independently; they were provided in large part by evidence of a strengthening in final purchases, i.e., expenditures for GNP other than for inventory accumulation.

A key element in the rise of final demand was the increase in expenditures at all levels of government. The upward trend of State and local government purchases continued unabated. The promotion of economic recovery was a major aim of Federal budget policy in 1961. Scheduled obligations and expenditures were speeded up in the numerous ways listed in Part II and the Appendix to this chapter. Additional outlays came from new Administration programs—some to assist individuals and areas hit by economic recession and others to meet national needs of high priority. Furthermore, in the spring and summer of 1961 when overriding national security requirements led to increased expenditures for defense and space activities, the existence of unutilized manpower and capital ruled against an increase in tax rates. A careful appraisal of the direct and indirect effects of increased Federal activity indicates that it was a major force—probably the principal driving force—of the recovery of 1961.

Investment in nonresidential construction and producers' durable equipment, taken together, rose at an annual rate of $3.4 billion (1961 prices) from the first to the last quarter of 1961, both responding to and contributing to the expansion (Table 5). With improving rates of utilization of capacity, larger corporate profits, and readily available credit, business fixed investment began to rise in the second quarter of 1961. In contrast, business capital outlays had continued to decline during two quarters of rising total output in both 1954 and 1958.

Residential nonfarm construction, which had fallen since mid-1959, picked up in the early months of 1961 and continued to rise through the year. Although the rate of new family formation has been relatively low, and vacancy rates have continued to rise steadily, increasing disposable incomes and favorable financial and liquidity conditions have stimulated home building. Through much of 1960 and well into 1961, individuals continued to increase their volume of liquid assets. Funds for conventional, FHA, and VA mortgages were readily available; mortgage yields declined moderately throughout the recession and into the summer of 1961 and remained fairly stable the rest of the year.

The favorable financial environment for business investment and residential construction reflected the monetary and credit policies of the

Government. These policies have facilitated the flow of funds into investment and have contributed to a stability of interest rates unusual for a year of recovery.

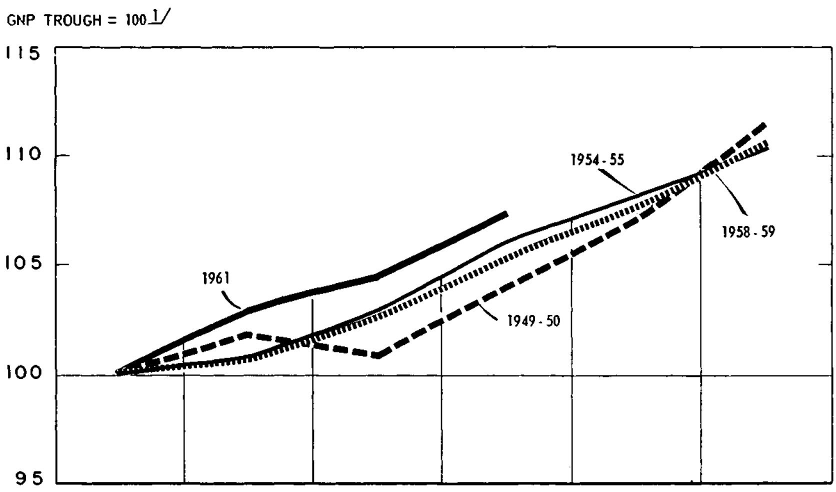
Exports in the fourth quarter were $0.8 billion (annual rate) higher than in the first quarter. But outlays on imports, partly to rebuild inventories, rose by $2.1 billion, reducing net exports by $1.3 billion. Net exports is the one component of GNP which tends to fall as business activity improves cyclically.

Consumer outlays accounted for somewhat less than half the increase in GNP from the first to the fourth quarter. Until the closing months of the year, consumer spending did not quite keep pace with disposable income. The ratio of personal saving to personal disposable income rose from 6.7 percent in the first quarter to 7.3 percent in the third. In the fourth quarter, however, consumption did keep pace with income and expanded by $8.0 billion (current prices, annual rate). Demand for new automobiles sparked a rise in the fourth quarter of $3.2 billion (annual rate) in outlays for consumer durable goods, which finally surpassed the peak that had been reached in the second quarter of 1960.

The gains in production, income, and employment during 1961, in comparison with previous expansions, are shown in Charts 4 and 5. Chart 4 displays the rise of GNP from its lowest quarter in each recession. In

CHART 4

Real Gross National Product in Four Postwar Recoveries



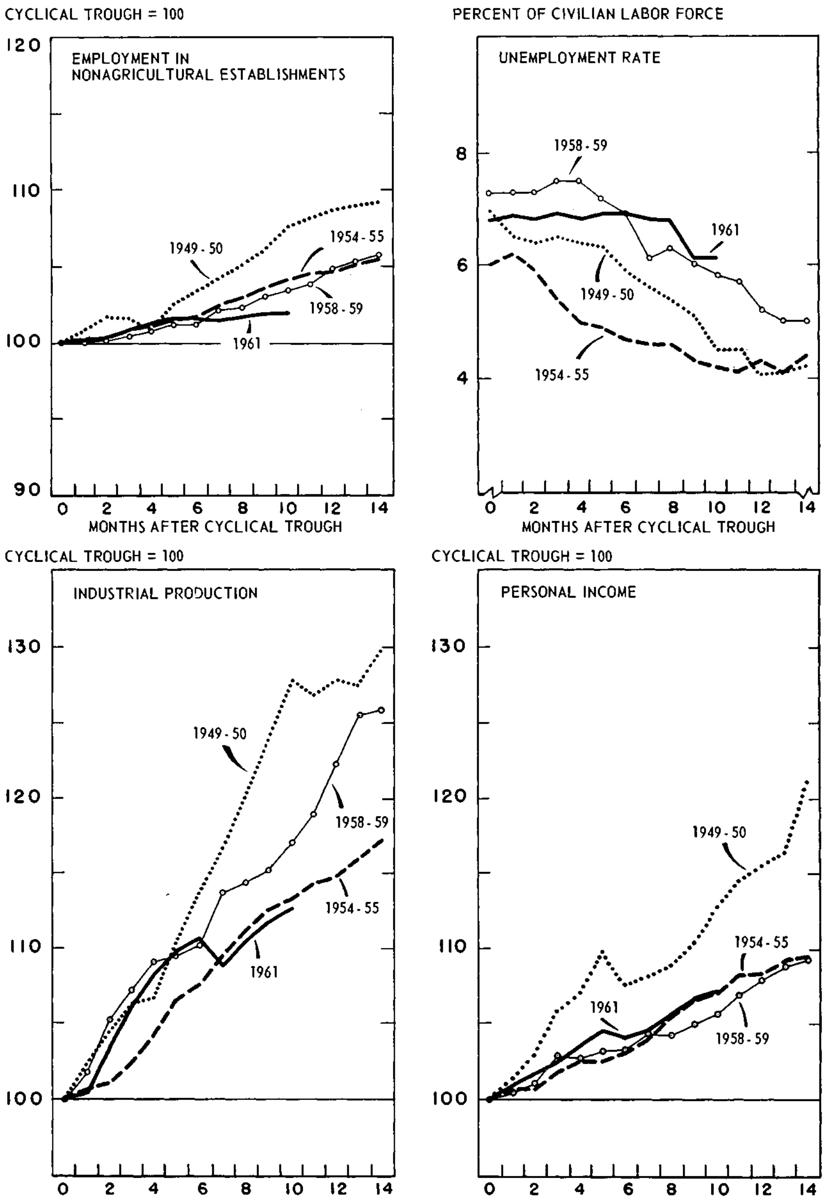
1/BASED ON SEASONALLY ADJUSTED DATA.

2/TROUGH QUARTERS FOR GNP WERE 1949 II, 1954 II, 1958 I, AND 1961 I.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

CHART 5

Employment, Production, and Income in Four Postwar Recoveries



NOTE: INDEXES AND RATE BASED ON SEASONALLY ADJUSTED DATA.

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

the three previous cycles, the trough quarter for GNP came before the month of the cyclical trough. In 1961 the cyclical trough, in February, was in the middle of the quarter of lowest GNP. In Chart 5 the reference point for all series is the cyclical trough month. These differences in timing must be taken into account in comparisons of recoveries. There are also differences in the composition of output: for example, the 1958–59 upswing was more heavily concentrated in industrial production than the current recovery.

On the whole, increases in production and income during the present expansion of economic activity compare favorably with the two preceding periods of expansion. However, these gains were not matched by equal improvements in employment and unemployment. As noted above, one of the principal reasons was that productivity gains during 1961 exceeded those of earlier expansions. The year ended with unemployment at 6.1 percent of the civilian labor force (seasonally adjusted).

In summary, real output rose during the 1961 recovery at an annual rate of 10 percent. The gap between actual output and estimated potential has been narrowed by $23 billion in three quarters; labor and capital have been more efficiently utilized; and widespread gains in income have been secured. The Nation has adjusted smoothly and easily to the marked change of pace: no evidence of strain can be found, no bottlenecks have developed, no excessive backlogs of orders have appeared. And prices have been exceptionally stable, as Chapter 4 makes clear. Although the economy at the end of 1961 was still short of full employment, the experience during the year was gratifying and reassuring on many counts. And it demonstrated the ability of the economy to advance efficiently at a rapid pace when the underlying strength of private demand is reinforced by appropriate Federal fiscal and monetary policies.

Outlook for 1962

The Employment Act of 1946 requires an estimate of "current and foreseeable trends in the levels of employment, production, and purchasing power." Although the difficulties and risks of economic forecasting are well known, neither government nor private enterprise can conduct its affairs, develop its policies, and make its decisions without economic projections—without making the best estimates that economic and statistical tools permit of the economic framework within which it will have to operate in the future. For example, it would be impossible to formulate either Federal or State budgets without projections of future levels of income and business activity and the tax revenues they will produce. In the Budget Message, GNP for 1962 is projected at $570 billion (current prices), a rise of nearly $50 billion, or almost 9½ percent, over 1961. A somewhat higher figure is likely if the Congress enacts promptly the Administration's proposed tax credit for investment. This section presents, with full recognition of the margins of error inherent in economic projections, the appraisal of the economic outlook underlying the budget.

The momentum of the current recovery will carry the economy to new records in production, income, and employment during 1962. In the closing months of 1961, private demand was rising briskly. The resulting gains in consumer incomes, profits, business inventory requirements, and orders for durable goods will generate further increases in spending and business activity in the coming months. Broad advances in the private economy will be reinforced by a continued upward trend in Federal, State and local government outlays.

The favorable prospects for private demand, together with current economic programs and proposals of the Administration, point to a strong and sustained expansion. The percentage gain in GNP (current prices) in 1962 over the 1961 level can realistically be expected to match the increases of 8½–9½ percent in 1955 and 1959. Those two years, like 1962, were the first full years of recovery from recession.

Expansion in GNP in 1962 is expected to be somewhat more moderate than the annual rate of 11 percent (current prices) attained over the past three quarters. But it is anticipated that output will continue to catch up with potential, reducing slack and unemployment. Substantial increases are expected in all major categories of expenditure. The expected total increase is made up, very roughly, of the following parts: one-half, consumer outlays; one-fifth each, government purchases and private fixed investment; and one-tenth, additions to inventories.

Survey of Major Categories of Expenditure

The rationale for this appraisal of the outlook may be indicated by a brief survey of the key components of GNP.

Consumption. The ratio of total consumer expenditure to personal disposable income, 93.0 percent in 1961, is expected to rise slightly in 1962. The proportion of income spent on nondurable goods and services typically declines during expansion and, this year, will probably fall below the 81.3 percent recorded in 1961. In prosperous periods, consumers devote a larger share of their incomes to increasing their wealth. But at the same time they show a preference for accumulating wealth in the form of consumer durable goods. The current strong liquid position of households is likely to moderate their desire for additional liquidity and to reinforce demands for durable goods this year. The brisk sales of automobiles in the fourth quarter of 1961 also point in this direction. An increase in expenditures for durables from 11.6 percent of disposable income in 1961 to some 12½ percent, approaching the proportions recorded in 1959 and 1960, will probably outweigh the slight decline to be expected in the fraction devoted to nondurables and services.

Measured absolutely, rather than as shares of disposable income, all components of consumer expenditure seem headed upward in 1962. Personal disposable income is likely to grow substantially. It will probably advance at a somewhat slower rate than GNP for the following reasons: (1) Corporate profits rise sharply in cyclical upswings, and dividend payments lag behind. (2) Government transfer payments to individuals are held down when unemployment declines. (3) Collections from progressive personal income taxes rise somewhat faster than personal incomes. But disposable income will still absorb more than half of the dollar gains in GNP, and consumer expenditure will account for about half of the total increment in expenditure. Consumption is now about 65 percent of GNP; no economic expansion can go far without support from consumers, and every expansion provides substantial income gains for households. A rise of $50 billion in GNP for 1962 would be accompanied by an increase of about $100 in consumption per capita, permitting significant advances in standards of living.

Government. State and local governments can be expected to add about $1 billion a quarter to their purchases of goods and services, continuing their steady upward trend. Federal purchases of goods and services will rise during 1962 but more slowly than over the past year. The average increase during the course of 1962 seems likely to be $1 billion a quarter, compared with $1.7 billion in 1961. New Federal obligations, which have some effect on business activity before the outlays they foreshadow, are expected to rise by $5 billion in the year starting next July 1—after a rise of $12½ billion in the current fiscal year.

Inventories. Inventory-sales ratios have declined markedly during this expansion, as is usual in the first year of an upswing. The ratio of inventories to GNP fell by about 5 percent over the last three quarters of 1961. More rapid accumulation is to be expected—and welcomed—in the near future. Analysis supported by prior cyclical experience suggests that inventories will soon begin catching up with total output. If they were to rise at a quarterly rate of 2 percent, inventory investment would attain an annual rate of more than $8 billion some time in 1962.

The threat of a midyear steel strike may produce added stockpiling this spring. In the absence of a prolonged strike, the main effect would be on the pattern of activity during the year, with the second quarter stronger and the third quarter correspondingly weaker. Although the year-end levels and the full year totals might not be seriously affected, this abnormal factor in inventory behavior would increase the difficulties of appraising the real strength of the economy. A long strike, of course, could seriously imperil the prospects for continued vigorous expansion.

Quite apart from the steel situation, inventory investment is likely to reach its peak before the end of 1962 and cannot be expected to be a significant expansionary factor in the latter half of this year.

Residential construction. With the aid of continued credit ease and increased household incomes, residential construction ended 1961 with a rate of activity $2 billion above the average for the year. Further moderate gains are likely, in part from additions and alterations and in part from new housing starts. Industry and government specialists have predicted housing starts of 1.4 million in 1962. Mortgage availability will influence housing demand considerably. If funds remain readily available, gains in household incomes are likely to strengthen the demand for new homes.

Business fixed investment. As Chart 3 shows, rates of capital utilization have been more favorable to investment demand in the last year than in 1958. Business outlays for durable equipment and nonresidential construction have risen more promptly and more vigorously to date than in the comparable stage of the preceding expansion. Incentives to invest for modernization and replacement purposes are also favorable. Furthermore, business fixed investment is volatile; in peacetime expansions, it usually rises as a fraction of GNP. Even the weak expansion of 1958–60 produced a 22 percent increase in capital outlays from their low in the third quarter of 1958 to their peak in the second quarter of 1960. The same performance in the current expansion would mean a rise of $6 billion from the last quarter of 1961 to the last quarter of 1962. And the major determinants of investment—corporate liquidity and profit rates, capacity measures, conditions in financial markets—point to more strength than in the last expansion. It seems probable that capital outlays in 1962 will surpass their 1958–60 performance.

Prospects for plant and equipment investment are difficult to assess quantitatively. Recent surveys suggest that businessmen have not yet planned any major expansion of productive facilities. But improved economic conditions have consistently led to substantial upward revisions of plans. Whether business fixed investment as a share of GNP, 8.9 percent in 1961, will approach the 1956 and 1957 figure of 10.7 percent or even substantially surpass the 1960 figure of 9.3 percent cannot be foretold. Much depends on the extent to which excess capacity declines over the next few quarters and on the willingness of businessmen to count on continued prosperity. Capital outlays will also be significantly influenced by the state of financial markets. The financing of investment will be facilitated by the rising flow of internal funds from retained earnings and depreciation allowances. But corporate investment is almost certain to exceed corporate saving in 1962. Corporations as a whole have strengthened their liquidity position, in part by long-term financing ahead of investment needs in 1961. Nevertheless, they will probably require substantial net external financing this year, involving an increase in the security holdings of households and financial institutions. Monetary policy can facilitate this external financing.

An important stimulus to capital outlays would be provided by enactment of the proposed tax credit of 8 percent on expenditures for new durable equipment. This measure would raise significantly the after-tax return on new investment. Enactment of the tax credit will help assure sufficient strength in this central component of demand at the crucial stage of the recovery.

Another favorable factor for the later stage of recovery is the planned revision by the Treasury of guideline schedules of depreciation on plant and equipment. The revision will incorporate available current information about the economic lives of capital goods and the effects of technological change on obsolescence.

In 1955–57, capital outlays amounting to more than 10 percent of potential and actual GNP led to an annual rate of growth of slightly less than 4 percent in the business capital stock. Because total output did not grow at an equal pace after 1955, excess capacity developed and capital outlays were sharply reduced in the 1957–58 recession. The excess capacity that emerged is more accurately attributed to underbuying than to overbuilding. If purchases by consumers and government had been sufficient to keep the economy fully employed, rates of capital utilization would not have fallen. Business firms would have had sustained incentives to enlarge their productive facilities at the rate of nearly 4 percent a year. Better performance in maintaining full use of resources could justify business fixed investment amounting to 10 percent or more of the Nation's output.

Prospects for Full Employment

This appraisal of the prospects for production and income implies an unemployment rate of 5 percent or somewhat lower at the end of 1962, but not as low as 4 percent.

The achievement of 4 percent unemployment by mid-1963 requires a gain of about 11 percent in GNP (in constant prices) over the coming year and a half. This pace of advance would permit smooth and efficient adjustments, avoiding bottlenecks that might generate serious upward pressures on prices. It would also allow a gradual transition toward the rates of expansion that must be expected when full utilization is restored and output can no longer rise more rapidly than productive potential. A continued upward movement for more than two years with an over-all gain of 20 percent in real GNP would represent a very strong expansion. But a less ambitious rate of recovery to full employment would prolong the waste of unused resources without gaining appreciably greater assurance of stable prices.

While this rate of expansion seems feasible in the light of the prospects for private demand and Administration policies designed to promote expansion at a desirable pace, any appraisal of the economic outlook must take into account a wide range of possible outcomes. Weakening of consumer demand or lack of investment enthusiasm by business firms could endanger the prospective gains of 1962 and slow down the expansion. Because of the growth in the labor force and productivity, 1962 could achieve new highs in output and even in employment without any reduction in the currently excessive rate of unemployment. Large and continuing gains are needed to bring output up to the economy's potential and to reduce unemployment to 4 percent of the labor force for the first time since 1957.

An expansion that slows down prematurely is less likely to be lasting. A slowdown, or even an expected slowdown, in the growth of sales can diminish incentives to enlarge productive capacity and inventories. A decline in capital spending and inventory accumulation can convert a slowdown into a downturn. For this reason, prospects for a lasting expansion rest heavily on the vigor of the upswing over the next few quarters.

The buildup of inventories that is expected in the near future will contribute substantially to household incomes and to the strength of consumer demand. But by late 1962, continued advance will depend heavily on the ability of fixed investment outlays to replace inventories as a key expansionary force. If the expansion is vigorous earlier in the year, utilization rates will be favorable to investment demand in late 1962, and, therefore, to the continuation of the expansion itself.

On the other hand, private demand can rise too fast or too far. Too rapid an expansion may strain the adjustment mechanisms of the economy. In a dynamic economy, patterns of output and employment change from one cycle to the next. It takes time to re-employ the jobless and to return efficiently to full utilization of capacity. Hence, a very rapid expansion of demand might involve price increases, bottlenecks, and inefficiencies that could be avoided in a more gradual rise to the same levels. The current expansion has an enviable record to date: with a 10 percent annual rate of increase of real output, it has substantially narrowed the gap between actual and potential output; at the same time, the movements of prices, inventories, and orders show none of the symptoms of strain that would be associated with excessive speed. If demand for consumer durable goods and business capital formation were quickly to attain the same strength relative to incomes as in 1955, reasonable speed limits might be violated. In that event, full employment might be achieved sooner but policy might have to contend with excess demands and inflationary pressures.

Still another challenge to policy might come from unexpected behavior of unemployment relative to output. Given continued growth of potential output along the 3½ percent trend discussed earlier, the achievement of full employment in mid-1963 would be associated with GNP of $600 billion in 1961 prices. Deviations from historical trends in the size of the labor force, average hours of work, and man-hour productivity can alter the relationship between output and unemployment. Full utilization of resources may correspond to a somewhat higher or somewhat lower GNP. In particular, the effects of measures (discussed in Chapter 2) to increase the rate of growth of productivity, while adding to investment demand during the expansion, may raise the productive potential output of the economy above its current trend as early as 1963.

Stabilization policy has contributed significantly to the gratifying progress of 1961 and to the favorable prospects for 1962. Policy will continue to promote progress toward full employment, remaining alert to unforeseen developments which might throw the economy off course. The flexibility in existing policy instruments can be used to good advantage, as it was in 1961. Furthermore, Administration proposals now before the Congress would greatly enhance the ability of stabilization policy to counter threats of oncoming recession with speed and vigor. The record of stabilization policy in 1961 and its tasks for 1962 are discussed in the remaining part of this chapter.

PART II: POLICIES FOR MAXIMUM EMPLOYMENT AND PRODUCTION

In Part I of this chapter, the progress of the economy in 1961 and the prospect for further progress in 1962 were reviewed in terms of the objectives of maximum employment, production, and purchasing power. Part II describes more fully and specifically how government policy can, does, and will promote progress toward these goals. Two major kinds of government policy are involved: measures for economic stabilization, which influence the total volume of spending; and measures to reduce structural unemployment and underemployment by better mutual adaptation between available jobs and available workers.

Economic Stabilization

Insufficient demand means unemployment, idle capacity, and lost production. Excessive demand means inflation—general increases in prices and money incomes, bringing forth little or no gains in output and real income. The objective of stabilization policies is to minimize these deviations, i.e., to keep over-all demand in step with the basic production potential of the economy.

Stabilization does not mean a mere leveling off of peaks and troughs in production and employment. It does not mean trying to hold over-all demand for goods and services stable. It means minimizing deviations from a rising trend, not from an unchanging average. In a growing economy, demand must grow in order to maintain full employment of labor and full utilization of capacity at stable prices. The economy is not performing satisfactorily unless it is almost continuously setting new records of production, income, and employment. Indeed, unless production grows as fast as its potential, unemployment and idle capacity will also grow. And when the economy starts from a position well below potential, output must for a time grow even faster than potential to achieve full utilization.

The Postwar Record

Despite the recessions of recent years and the inflationary excesses of the early postwar years, the postwar record of economic stabilization is incomparably better than the prewar. The economy fluctuated violently in 1919–21 and operated disastrously far below potential from 1930 to 1942. The 1929 level of GNP, in constant prices, was not exceeded, except briefly in 1937, until 1939. The difference between the 17 percent unemployment of 1939 and the 3 percent rate 10 years earlier is a dramatic measure of the growth of the labor force and productivity even during depression. Since the war, the economy's detours from the path of full employment growth have been shorter in both time and distance. There have been four recessions, but none of them has gotten out of hand, as did the decline of 1929–33. All of the declines have been reversed within 13 months, before unemployment reached 8 percent of the labor force. For this improved performance there are several reasons.

First, the war and preceding depression left business firms and households starved for goods. Further, wartime earnings coupled with scarcities of civilian goods, rationing, and price control, saturated business firms and consumers with liquid assets. For these legacies of depression and war, the economy paid a price in the inflations of 1946–48 and 1950, with delayed effects throughout the past decade.

Second, the structure of the economy was reformed after 1933 in ways which substantially increased its resistance to economic fluctuations. The manner in which government tax revenues and income maintenance programs serve as automatic or "built-in" economic stabilizers is described below. The New Deal strengthened and reformed the Nation's banking and financial system with the help of new governmental credit institutions, deposit insurance, and loan and guarantee programs. These have virtually eliminated the possibility that economic declines will be aggravated by bank failures, foreclosures, and epidemic illiquidity.

Third, there is a significantly improved understanding of the manner in which government fiscal and monetary tools can be used to promote economic stability. Under the Employment Act and the climate of opinion which it symbolizes, the Government has been expected to assume, and has assumed, greater responsibility for economic stabilization.

Finally, businessmen and consumers no longer regard prolonged and deep depression as a serious possibility. They generally expect recessions to end quickly; they anticipate a long-term upward trend in the economy; and they spend and invest accordingly. This stability of expectations is in part the result of stability achieved in fact, and reflects general understanding of the structural changes which have contributed to it. But expectations of stability are also a cause of stability—nothing succeeds like success.

Achieving Greater Stability

While our postwar performance is a great advance over that of prewar years, it is still far from satisfactory. We have had no great depression, but we have had four recessions. Even the relatively short and mild recessions of the postwar period have been costly. In the last decade, the Nation has lost an estimated $175 billion of GNP (in 1961 prices) by operating the economy below potential. Industrial production has been below its previous peak nearly half the time since 1946.

There is general agreement that economic fluctuations in the United States are intensified by—if not always caused by—a rhythm in inventory investment, alternating between periods in which stocks are accumulating at an excessively high rate and periods in which they are being liquidated. But it is not beyond hope that stabilization measures, both automatic and discretionary, can be strengthened in force and improved in timing so as to compensate for inventory swings better than has been true in the past. If this is done the swings themselves will be dampened.

The possible gains from improved economic stabilization are impressive. Losses of production, employment, and consumption will be cut. More saving and investment will be realized, contributing steadily to the long-run growth of production potential. Business, consumer, and labor decisions will allocate resources more efficiently when they respond less to cyclical prospects and more to long-run developments. There will be less need and less justification for restrictive practices which are now designed to provide sheltered positions in markets periodically hit by recession.

It is true that an economy operating steadily at a high level of employment, with only limited excess plant capacity, is more subject to the risks of price increases than an economy with heavy unemployment and large unused capacity. However, the dampening of economic fluctuations may itself help to counter this tendency. Cyclical fluctuations have been exerting a "ratchet effect" on prices; costs and prices have been relatively inflexible downward in recessions but have been responsive to increases in demand during recoveries. Cyclical swings in total spending also tend to be accompanied by sharp and transitory shifts in the composition of spending. Because prices and costs respond more readily to upswings than to downswings, these rapid changes in the composition of demand impart an upward bias to the whole price level. These sources of upward price bias will tend to be reduced as a more even pace of advance is achieved.

To capitalize on the potential gains of stabilization requires skillful use of all economic policy, particularly budgetary and monetary policy.

The Federal Budget and Economic Stability

Federal expenditures and taxes affect total employment and production by influencing the total volume of spending for goods and services. Direct Federal purchases of goods and services are themselves part of total demand for national output. In addition, the Federal Government makes "transfer payments" to individuals, for which no current services are rendered in return. Examples are social security and unemployment insurance benefits, and veterans compensation and pension benefits. Both purchases of goods and services and transfer payments add to private incomes and thereby stimulate consumption and investment. Federal taxes, on the other hand, reduce disposable personal and business incomes, and restrain private spending.

By increasing the flow of spending, additional Federal outlays—with tax rates unchanged—have expansionary effects on the economy. Whether an expansion in spending—government or private—leads mainly to more output or mainly to higher prices depends on the degree of slack in the economy. Under conditions of widespread unemployment and excess capacity, businessmen respond to higher demand by increasing production; under conditions of full employment, prices rise instead. In the slack economy of 1961, for example, additional demand from both private and public sources was readily converted into increased production.

Built into the Federal fiscal system are several automatic defenses against recession and inflation. Given the tax rates, tax revenues move up and down with economic activity, since most taxes are levied on private incomes or sales. Indeed, tax revenues change proportionally more than GNP. Furthermore, certain Federal expenditures, such as unemployment compensation payments, are automatically affected by the state of the economy. Economic fluctuations, therefore, result in substantial changes in Federal expenditures and revenues, even when basic expenditure programs and tax rates remain unchanged. With the present system of tax rates and unemployment compensation payments, a one-dollar reduction in GNP means a reduction in Federal tax receipts and an increase in transfer payments totaling about 30 cents. Therefore, private incomes after Federal taxes fall by only 70 cents for each reduction of one dollar in GNP. For this reason, any initial decline in spending and output is transmitted with diminished force to other sectors of the economy.

These automatic or built-in stabilizers moderate the severity of cyclical swings in the economy. If the forces causing a downturn in economic activity are weak and transient, the automatic stabilizers cushion the severity of the decline and give the basic recuperative powers in the private economy a better opportunity to produce a prompt and full recovery.

But if the forces causing the downturn are strong and persistent, the built-in stabilizers may not suffice to prevent a large and prolonged recession. Furthermore, they are blindly symmetrical in their effects. When economic activity quickens after a slump, the rise in Federal revenues begins immediately and slows the recovery in employment and incomes. For these reasons, the task of economic stabilization cannot be left entirely to built-in stabilizers. Discretionary budget policy, e.g., changes in tax rates or expenditure programs, is indispensable—sometimes to reinforce, sometimes to offset, the effects of the stabilizers.

To be effective, discretionary budget policy should be flexible. In order to promote economic stability, the Government should be able to change quickly tax rates or expenditure programs, and equally able to reverse its actions as circumstances change. Failure to arrest quickly a downturn in income, production, and employment may shake the faith of firms and households in prompt recovery and thereby lead to a cumulative decline. Delay in countering inflationary pressures may permit the development of a self-propelling speculative boom, with disruptive consequences to the domestic economy and the balance of payments. If moderate fiscal action can be taken quickly and can be speedily reversed when circumstances warrant, the dangers of overstimulating or overrestricting the economy are much smaller than if fiscal responses are sluggish and difficult to reverse.

Fiscal policy can be made a more flexible and more powerful tool of economic stabilization by means that do not change the basic structure and level of taxation or the long-run size and composition of Federal expenditure programs. Changes in the basic structure and level of taxation should be made by the Congress with full deliberation in the light of the many relevant considerations, including the long-run revenue needs of the Government, equity among individuals and groups, and the effects of various taxes on economic efficiency and growth. Similarly, changes in the magnitude and content of government expenditures should represent the considered judgment of the people and the Congress on national priorities. For purposes of economic stabilization all that is needed of tax policy is temporary variation in the general level of tax rates within the existing structure, and all that is required of government outlays is timing of certain expenditures so that they bolster employment and purchasing power when the economy needs stimulus and taper off as it approaches full employment. In both cases, the form of action required for purposes of stabilization and the procedure for taking timely action can be agreed upon in advance.

The President's Recommendations

The President has recommended a three-part program for economic stabilization. Its enactment would be the most significant step forward in policy for economic stabilization since the Employment Act itself. These three measures parallel recommendations of the Commission on Money and Credit, a private group of leading citizens representing diverse economic interests and viewpoints.

Stand-by capital improvements authority. Under the first measure, the Congress would give the President stand-by authority to initiate at a time of rising unemployment up to $2 billion of public investments. More specifically, the program of accelerated capital improvements could be initiated by the President within two months after the seasonally adjusted unemployment rate (a) had risen in at least three out of four months (or in four out of six months) and (b) had risen to a level at least one percentage point higher than its level four months (or six months) earlier. Before invoking this authority, the President would be required to make a finding that current and prospective economic developments require such action to achieve the objectives of the Employment Act.

Under the program, the President would be authorized to commit up to (1) $750 million for direct Federal expenditures, (2) $750 million for grants-in-aid to State and local governments, (3) $250 million in loans to such States and localities as would otherwise be unable to meet their share of project costs, and (4) a further $250 million to be distributed among the above three categories as he might deem appropriate. Once initiated, the program could be terminated at any time by the President.

The program is designed to permit the timely initiation and execution of capital improvement projects which are desirable in their own right. To insure that the projects are appropriately timed, several important safeguards are incorporated in the proposal. An expanded capital improvements program initiated by the President under this authority would automatically be terminated within 12 months after initiation, unless extended by the Congress. Once a program had been terminated, a new program under this authorization could not be initiated by the President for 6 months. With respect to grant-in-aid expenditures, the President would be required to prescribe rules to assure that assisted projects were of high priority, were a net addition to existing State and local expenditures, and were of the type which could be started quickly and carried speedily to conclusion. Under existing legislation, Federal advances are provided to aid State and local governments to plan projects which would meet these specifications.

To insure that the projects are desirable on their own merits, the proposal would limit direct Federal expenditures to projects and programs previously authorized by the Congress. Appropriate projects would include resource conservation (e.g., reforestation, reseeding of range lands, timber stand improvement) and various Federal public works, including construction, repair, or modernization of Federal buildings. Examples of projects for which State and local governments could receive grants are hospitals, airports, schools, waste treatment facilities, street repairs and improvements, water and sewer systems, and deferred maintenance and improvement of public buildings.

The unemployment criteria for triggering the accelerated capital expenditures program are rigorous enough to prevent untimely or premature activation, but not so restrictive as to delay the effects of the program until late in the recovery period. The criteria for initiation of the program would have been met in the early stages of each of the four postwar recessions. Furthermore, no false signals would have been given. Even if the criteria were to give a false signal in the future—for example if unemployment were to rise because of a major strike—the President simply need not invoke the authority.

Table 6 shows the dates at which the unemployment criteria would first have been met in each recession of the past decade, the date of the previous peak, the date of the low point of the recession, and the date at which the economy subsequently returned to full employment. In every case, Presidential authority could have been invoked within four months after the previous cyclical peak and well before the trough of the recession. The first impact of orders, contracts, and expenditures under the program would have been felt within one or two months after the authority was invoked.

TABLE 6.—*Hypothetical timing of proposed capital improvements program in four postwar business cycles*

Business cycle peak	Unemployment criteria met [1]	Business cycle trough	Subsequent achievement of full employment [2]
November 1948	March 1949	October 1949	October 1950
July 1953	November 1953	August 1954	July 1955
July 1957	November 1957	April 1958	(3)
May 1960	August 1960	February 1961	(3)

[1] Criteria are met in any month in which the seasonally adjusted unemployment rate (a) had risen in at least three out of four months (or in four out of six months) and (b) had risen to a level at least one percentage point higher than its level four months (or six months) earlier. Program could be initiated within two months after criteria are met.

[2] The date at which the economy returned to the neighborhood of a 4 percent unemployment rate.

[3] Full employment has not been achieved since the beginning of the 1957 recession.

Source: Council of Economic Advisers.

The major impact of the program would occur when a stimulus is needed to arrest economic decline or support recovery. It would not be delayed until private demands are already pressing hard on the economy's capacity to produce. Table 6 indicates that a quick-starting, fast-moving capital expenditures program begun in the early stages of recession could have been terminated before the economy returned to full employment.

Stand-by tax reduction authority. The second recommendation is to establish a procedure for making quickly a temporary across-the-board reduction in the individual income tax rate. Such a reduction would be a speedy and powerful method of augmenting purchasing power throughout the Nation.

Specifically, the President would be given stand-by authority, subject to congressional veto, to reduce temporarily all individual income tax rates, in accordance with the following procedure:

(1) Before proposing a temporary tax reduction, the President must make a finding that such action is required to meet the stabilization objectives of the Employment Act.

(2) Upon such finding, the President would submit to Congress a proposed temporary uniform reduction in all individual income

tax rates. The proposed temporary rates may not be more than 5 percentage points lower than the rates permanently established by the Congress.

(3) This change would take effect 30 days after submission, unless rejected by a joint resolution of the Congress.

(4) It would remain in effect for 6 months unless revised or renewed by the same process or extended by a joint resolution of the Congress.

(5) If the Congress were not in session, a Presidentially proposed tax adjustment would automatically take effect but would terminate 30 days after the Congress reconvened. Extension would require a new proposal to the Congress, which would be subject to congressional veto.

An across-the-board variation in the basic individual income tax rate can be a potent stabilization measure. At the current level of taxable income, a reduction of 1 percentage point in the tax schedule would add about $2 billion, at annual rates, to disposable personal income, and a full 5 point reduction would increase disposable income by $10 billion. Since nearly three-quarters of the individual income tax is collected through payroll deductions, the rate reduction would have an immediate effect upon incomes available to consumers. Payments of taxes on estimated declarations would also be reduced, raising still further the current flow of consumer incomes. Higher consumer incomes mean higher consumer spending. The resultant expansion in output and employment by the consumer goods industries and their suppliers would increase the incomes of those already employed and create jobs for many of the unemployed.

Policy to reverse recession or speed recovery often calls for a temporary boost in private purchasing power. Permanent reduction in tax rates could give the economy as strong, or stronger, a stimulus but at the possible sacrifice of tax revenues which would be most desirable after the economy returned to full employment. Private demands are weak in periods of recession and slack, but a large part of their weakness results from recession and slack themselves. Once full employment has been restored, with the help of the temporary tax reduction as well as other measures, private demands will be stronger simply because capacity operation is itself a powerful stimulus. At that time, the private economy no longer needs the fiscal stimulus which is appropriate to reverse a decline or support a recovery. In that case a return to permanent tax rates may be desirable in order to provide room in a non-inflationary full employment economy for defense outlays and other continuing government programs of high priority. Indeed, a Federal surplus, normally to be expected at full employment, will provide saving to finance private investments stimulated by capacity operations and prosperity profits. Under the proposal, a tax adjustment can be speedily invoked to

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meet the temporary requirements of economic stabilization, without permanently sacrificing revenues needed at a later date.

Improvement of the unemployment compensation system. The third major recommendation is to strengthen the Federal-State unemployment compensation system. The proposed legislation will make the unemployment insurance system more effective in meeting its two objectives. Individual workers will be more secure against the risks of unemployment. The economy will be more secure against the risks of sharp declines in purchasing power.

As pointed out in Part I of this chapter, unemployment benefits are now generally smaller, relative to earnings, than the 50 percent envisaged when the system was first inaugurated a generation ago. Furthermore, it has been necessary during the last two recessions to enact temporary legislation to extend the period of unemployment compensation for the large numbers of workers who had exhausted their benefit rights. To insure that experienced workers who suffer long-term unemployment during periods of prosperity will receive the same benefits as during recessions, the Administration has proposed a permanent Federal program under which the period of unemployment compensation would be extended by as much as 13 weeks for workers who have had at least three years' experience in insured work. The proposal also provides, when unemployment is widespread, a Federal program extending the period of benefits for all insured workers, including those who do not qualify for the permanent program of extended benefits because they have had less than three years of experience in insured work. This extension could be put into effect upon proclamation by the President when insured unemployment has reached 5 percent and the number of benefit exhaustions in a three-month period has reached 1 percent of insured employment. In these periods, regular benefits are exhausted by large numbers of workers and particularly by workers who have only limited experience in insured employment.

To raise the percentage of wages compensated by unemployment insurance and to accomplish other needed reforms, the following recommendations are made: (1) an additional three million workers should be covered; (2) States should be required to meet higher standards with respect to the amount of weekly benefits; (3) States which have experienced heavy insured unemployment should receive reinsurance grants; (4) a State may not deny compensation to claimants undergoing approved training.

Since the unemployment compensation system is an insurance program designed to be self-financing, increased benefits must be matched by increased contributions. The proposal would increase the taxable wage base from $3,000 a year to $4,800 and make permanent the temporary increase adopted in 1961, which raised the net Federal unemployment tax from 0.4 percent to 0.8 percent.

These three recommendations together constitute a far-reaching innovation in discretionary fiscal policy. At the same time, they are moderate proposals, carefully defining and limiting the authority which they confer. They will go a long way toward providing the flexibility in fiscal policy which is essential if the Nation is to make prosperity the rule and not the exception in its economic life. In the past 7 years the Nation has undergone three recessions. In the 4½ years since 1957, full employment has not once been attained. While some fluctuations in business and consumer spending will always occur, nothing in our free enterprise economy condemns us to repeat this recent experience. Prudent innovations in the tools of fiscal policy, and careful use of both new and old tools, can greatly improve the stability of our economy in the years ahead.

Budget Policy, 1958–63

The Federal budget has influenced economic activity in recent years in two ways: through the workings of the built-in stabilizers, and through discretionary changes in the budget program. It is not easy to separate these two influences. In order to do so, it is necessary, first, to view Federal fiscal transactions in the same accounting framework used to describe the whole economy. The *national income accounts budget* is a way of measuring and classifying Federal transactions which accords with the national income and product accounts for the economy. Second, it is convenient to have a numerical measure of the expansionary or restrictive impact of a budget program on the economy. The *full employment surplus* is such a measure. This section discusses these two somewhat unfamiliar but highly useful tools and then applies them in an analysis of recent and prospective budget policies.

The National Income Accounts Budget

The effects of Federal receipts and expenditures on the income stream are most accurately represented when the budget is viewed in the framework of the national income accounts. These accounts present a consistent record and classification of the major flows of output and income for the entire economy, including the transactions of the Federal Government. There are three major differences between the Federal budget as it is conventionally presented (the so-called "administrative budget") and the accounts of the Federal sector as they appear in the national income. The major differences between these two budgets, and between both of them and the consolidated cash budget, are schematically summarized in Table 7. There are other, less significant differences among the budgets, such as the treatment of intragovernmental transactions.

First, the national income accounts budget, like the consolidated cash budget, includes the transactions of the trust funds, which amount currently to about $25 billion per year and have a significant impact on the economy. Highway grants-in-aid, unemployment compensation payments, and social security benefits are examples of trust fund transactions. Because

TABLE 7.—*Major differences among three concepts of the Federal budget*

Item	Budget concept		
	Administrative	Consolidated cash	National income accounts
Timing of receipts	Collections	Collections	Accruals
Treatment of net loans and other credit transactions	Included	Included	Excluded
Treatment of trust fund transactions	Excluded	Included	Included

Source: Council of Economic Advisers.

the traditional budget—or administrative budget—is primarily an instrument of management and control of those Federal activities which operate through regular congressional appropriations, it excludes the trust funds, which have their own legal sources of revenue.

Second, transactions between government and business are, so far as possible, recorded in the national income accounts budget when liabilities are incurred rather than when cash changes hands. This adjustment in timing affects both government purchases and taxes, shifting them to the point in time at which they are likely to have their principal impact on private spending decisions. The choice of an accrual, rather than a cash, basis for timing is particularly important for the highly volatile corporate income tax. Since these taxes are normally paid more than six months after the liabilities are incurred, payments of corporate income taxes, as recorded in the administrative budget, run substantially below accruals in a period of rising economic activity. For fiscal year 1962, this difference is estimated at about $3 billion.

Finally, unlike the administrative budget, the national income accounts budget omits government transactions in financial assets and already existing assets. The largest omission is the volume of loans extended by the Federal Government. This volume is estimated at $4 billion net of repayments in fiscal year 1962. While these loans have important effects on economic activity, they are properly viewed as an aspect, not of fiscal policy, but of monetary and credit policy, and are so discussed later in this chapter. Borrowers from the Federal Government, like borrowers from private financial institutions, acquire cash by incurring debts. They add thereby to their liquidity, but not directly to their incomes.

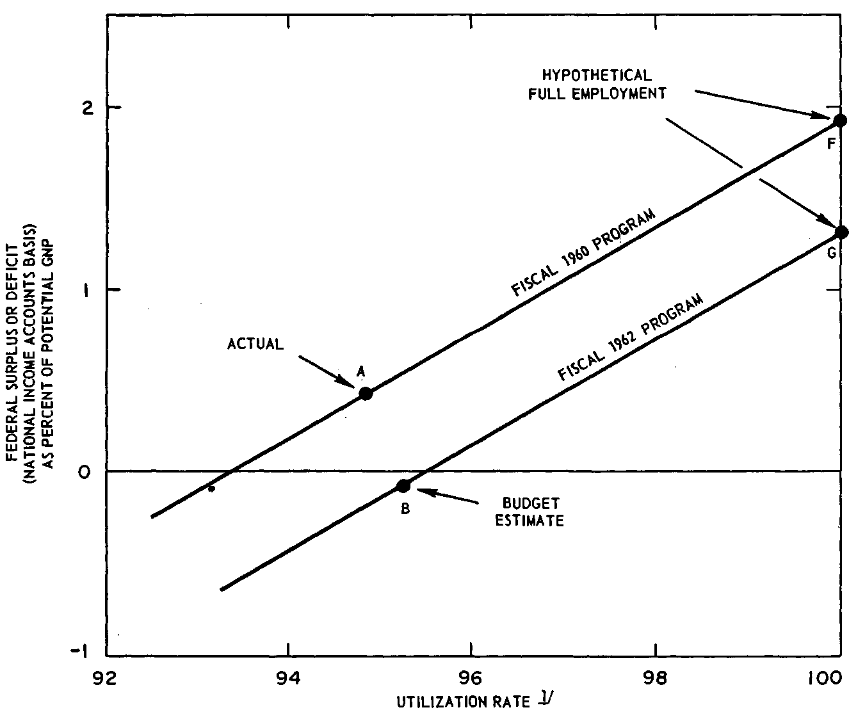
The Full Employment Surplus

As pointed out earlier in this chapter, the magnitude of the surplus or deficit in the budget depends both on the budget program and on the state of the economy. The budget program fixes both tax rates and expenditure programs. The revenues actually yielded by most taxes, and the actual expenditures under certain programs like unemployment compensation, vary automatically with economic activity. To interpret the economic significance of a given budget it is, therefore, essential to distinguish the *automatic* changes in revenues and expenditures from the *discretionary* changes which occur when the Government varies tax rates or changes expenditure programs. The discussion that follows runs in terms of the national income accounts budget.

In Chart 6 this twofold aspect of fiscal policy is portrayed for the fiscal years 1960 and 1962. Since tax revenues and some expenditures depend on the level of economic activity, there is a whole range of possible surpluses and deficits associated with a given budget program. The particular surplus or deficit in fact realized will depend on the level of economic activity. On the horizontal scale, Chart 6 shows the ratio of actual GNP to the economy's potential, labeled the "utilization rate." On the vertical scale, the chart shows the Federal budget surplus or deficit as a percentage of potential GNP.

CHART 6

Effect of Level of Economic Activity on Federal Surplus or Deficit



1/ACTUAL GNP AS PERCENT OF POTENTIAL GNP.
SOURCE: COUNCIL OF ECONOMIC ADVISERS.

The line labeled "fiscal 1960 program" represents a calculation of the budget surplus or deficit which would have occurred at various levels of economic activity, given the Federal expenditure programs and the tax rates of that year. For the reasons explained earlier, the same budget program may yield a high surplus at full employment and a low surplus or a deficit at low levels of economic activity. The actual budget position in fiscal year 1960, a surplus of $2.2 billion or 0.4 percent of potential GNP, is shown at point A; this accompanied a level of GNP 5 percent below potential. Had full employment been achieved that year, however, the same basic budget program would have yielded a surplus of about $10 billion, or nearly 2 percent of gross national product (point F in the chart). The line labeled "1962 program" similarly shows the relationship between economic activity and the surplus or deficit, for the budget program of 1962; the expected deficit is shown at point B, and the full employment surplus at point G.

It is the height of the line in Chart 6 which reflects the basic budget program; the actual surplus or deficit depends both on the height of the program line and the level of economic activity. In other words, discretionary fiscal policy, by changing the level of Government expenditures or tax rates shifts the whole program line up or down. The automatic stabilizing effects of a given budget program are reflected in the chart by movements along a given line, accompanying changes in economic activity. One convenient method of comparing alternative budget programs, which separates automatic from discretionary changes in surplus and deficits, is to calculate the surplus or deficit of each alternative program at a fixed level of economic activity. As a convention, this calculation is made on the assumption of full employment. In Chart 6, the points F and G mark the full employment surplus in the budget programs of fiscal years 1960 and 1962, respectively. The statement, "the fiscal 1960 budget had a larger full employment surplus, as a fraction of potential GNP, than the 1962 budget" is a convenient shorthand summary of the fact that the 1962 budget line was below the 1960 line, yielding smaller surpluses or larger deficits at any comparable level of activity.

The full employment surplus rises through time if tax rates and expenditure programs remain unchanged. Because potential GNP grows, the volume of tax revenues yielded by a fully employed economy rises, when tax rates remain unchanged. Full employment revenues under existing tax laws are growing by about $6 billion a year. With unchanged discretionary expenditures, a budget line drawn on Chart 6 would shift upward each year by about 1 percent of potential GNP.

The full employment surplus is a measure of the restrictive or expansionary impact of a budget program on over-all demand. Generally speaking, one budget program is more expansionary than another if it has a smaller full employment surplus. One budget program might have the smaller full employment surplus because it embodies greater Federal purchases of goods and services, in relation to potential GNP. By the same token, it leaves a smaller share of full employment output for private purchase. This means that full employment is easier to maintain under the budget program with the smaller surplus, because less private demand is required. It also means that inflation is more difficult to avoid, because there are fewer goods and services to meet private demand should it prove strong. Alternatively, one budget program might have a smaller full employment surplus than a second because it involves either lower tax rates or larger transfer payment programs. In that event, private after-tax incomes are larger at full employment for the first budget program than for the second. As a result, private demand would be stronger under the first program.

If the full employment surplus is too large, relative to the strength of private demand, economic activity falls short of potential. Correspondingly, the budget surplus actually realized falls short of the full employment surplus; indeed, a deficit may occur. If the full employment surplus is too small, total demand exceeds the capacity of economy and causes inflation.

But whether a given full employment surplus is too large or too small depends on other government policies, as well as on economic circumstances affecting the general strength of private demand. If the full employment surplus is too large, more expansionary monetary and credit policies may strengthen private demand sufficiently to permit full employment to be realized. Changes in tax structure, stimulating demand while leaving the yield of the tax system unchanged, might have the same effect. Similarly, restrictive changes in other government policies can offset the expansionary influence of a low full employment surplus.

A mixture of policies involving (1) a budget program with a relatively high full employment surplus and (2) monetary ease and tax incentives stimulating enough private investment to maintain full employment, has favorable consequences for economic growth, discussed in Chapter 2.

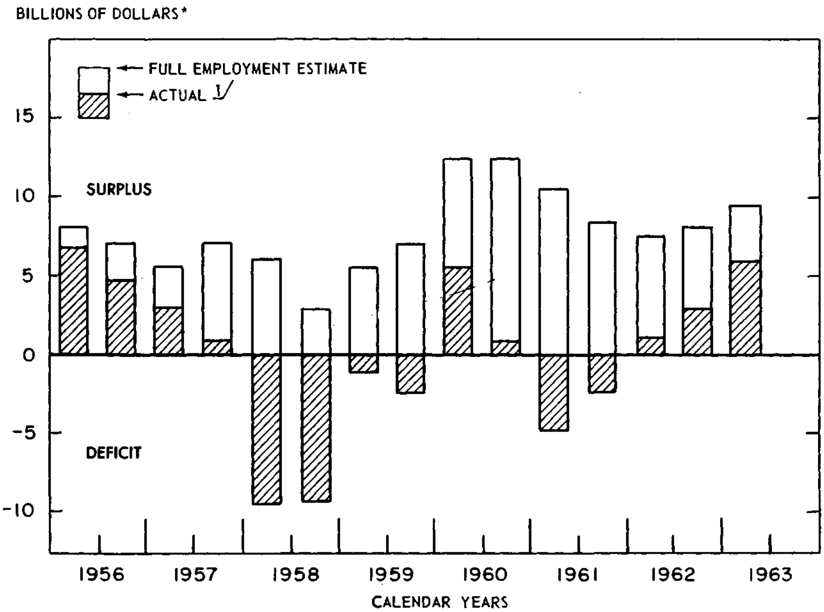
The Budget in 1958–60

The analysis of the budget program in terms of the full employment surplus points to a probable major cause of the incomplete and short-lived nature of the 1958–60 expansion. The most restrictive fiscal program of recent years was the program of 1960. Its full employment surplus exceeded any from 1956 to date. Estimates of the full employment surplus by half years are shown in Chart 7. The full employment surplus declined sharply as a result of higher expenditures during the 1957–58 recession until it reached an estimated $3 billion in the second half of 1958. Thereafter, it rose gradually through most of 1959 but then increased sharply to about $12½ billion in 1960. Thus, whereas the Federal budget contributed to stability during the contraction phase of the cycle and during the first year of the expansion, it was altered abruptly in the direction of restraint late in 1959 at a time when high employment had not yet been achieved.

CHART 7

Federal Surplus or Deficit: Actual and Full Employment Estimate

(National Income Accounts Basis)



*SEASONALLY ADJUSTED ANNUAL RATES; DATA ARE FOR HALF-YEARS.

1/ESTIMATED BEGINNING SECOND HALF 1961.

SOURCES: DEPARTMENT OF COMMERCE, BUREAU OF THE BUDGET, AND COUNCIL OF ECONOMIC ADVISERS.

Federal Fiscal Activity in 1961–62

Immediately upon taking office, the new Administration moved vigorously to use the fiscal powers of the Federal Government to help bring about economic recovery. Federal procurement was accelerated by Presidential directive early in February, and tax refunds were also expedited. A listing of Administration stabilization policies during 1961 is provided in the Appendix to this chapter. Changes in transfer programs added about $2 billion to the combined total of transfer payments for fiscal years 1961 and 1962. The Veterans Administration advanced the payment of $150 million of veterans' life insurance dividends into the first quarter of calendar year 1961, and then made an extra dividend payment of $218 million at midyear. The Congress promptly adopted a number of measures requested by the President. A Temporary Extended Unemployment Compensation Act was adopted, providing for extension of exhausted benefits and giving the Administration time to develop a comprehensive program for permanent improvement in unemployment compensation. Social security benefits were increased effective in August, and aid was extended to children dependent on unemployed persons. Transfer payments represent a major element of flexibility in Federal expenditures. While transfer programs—like any Federal outlays—ought to stand on their merits, the precise timing of worthwhile new programs properly depends on economic conditions. The objectives of economic stabilization in 1961 argued strongly for speeding the introduction of programs like improvements in social security, scheduled to be adopted later.

Other Federal outlays increased in 1961 to meet specific national needs. Federal grants to States and localities for urban renewal, area redevelopment, highways, and public assistance increased. Direct payments to farmers were increased as a result of participation in the feed grains program. The largest increases in expenditures came in the areas of defense and space exploration. These programs were expanded for reasons of national security, not for economic stabilization. However, stabilization objectives ruled against any increases in tax rates to finance these new expenditures.

During 1961, the estimated full employment surplus declined significantly, from an annual rate of $12½ billion in the second half of 1960 to $8½ billion in the second half of 1961. As shown in Chart 7, the actual surplus or deficit has been substantially different from its full employment counterpart. Since private incomes declined during late 1960 and into 1961, the actual budget position shifted from a surplus of $1 billion in the second half of 1960 to a deficit of $5 billion in the first half of 1961. Then as the economy began to recover, the deficit, in the national income accounts, shrank to $2 billion in the second half of the year. The rising deficit in the early part of 1961 was due both to a shift downward in its budget program line (as discretionary budget outlays were increased) and to a movement to the left along the new line (as private incomes and Federal tax receipts declined).

The Federal national income accounts budget appropriately showed its largest deficit early in 1961, when the economy was near the trough of recession. Since then, the deficit has been steadily declining in spite of rising expenditures, and a surplus is expected in the first half of 1962. The administrative and cash deficits show a different time pattern, with deficits rising in the 1962 fiscal year, primarily because tax collections lag behind tax liabilities.

The fiscal actions taken during the past year reflect the Administration's philosophy that the budget is a positive instrument for economic stabilization. According to the original January 1961 budget estimates, expenditures on national income-and-product account were expected to reach a level of $98 billion in fiscal year 1962. Present estimates, which incorporate all of the changes made by executive and legislative action, indicate that these expenditures will amount to more than $106 billion. This increase in expenditures is itself responsible for a rise in the gross national product that can be estimated conservatively at $15 billion.

Budget Policy for Fiscal 1963

The balanced administrative budget proposed for fiscal year 1963 projects an increase over the current fiscal year of nearly $6 billion in Federal outlays on income-and-product account. Because of the $2 billion a year increase in social insurance taxes effective January 1, 1963, the full employment surplus rises in the first half of 1963. But it remains considerably below the level of 1960 (Chart 7). Fiscal policy will be less restrictive than it was in the late stages of the last recovery. The budgetary program, yielding a surplus on income-and-product account of $4.4 billion reflects the reasonable expectation that 4 percent unemployment will be reached by the end of the 1963 fiscal year. The feasibility of this objective and the outlook for the economy have been appraised in detail in Part I above. Obviously, the strength of private demand over the next 18 months cannot now be assessed with precision. Any plans covering the uncertain future are necessarily risky. A less expansionary budget with a larger full employment surplus would provide added assurance of price stability but only at the cost of increased dangers of an incomplete recovery. A more expansionary budget would, on the other hand, improve the outlook for maximum production and employment but increase the risks of rising prices.

The risks of an incomplete recovery, on the one hand, or of rising prices on the other, are fortunately reduced by the automatic stabilizing characteristics of the budget. If private demand proves excessively bouyant, the added revenues can be expected to enlarge the surplus in the budget, thereby moderating inflationary pressures. Conversely, any shortfall in private demand will likewise be partially countered by a shortfall in tax revenues. In addition, discretionary policy will remain flexible. First, monetary policy can be used flexibly. The Federal Reserve can attune its policies to the pattern of output, employment, and prices as it unfolds during the months ahead. Second, as the experience of 1961 demonstrated, the budget itself is a flexible tool which can be adjusted during the course of a fiscal year by varying the timing of outlays and by legislative action. Finally, the President's stabilization proposals described earlier in this chapter, would, if adopted, significantly strengthen the government's ability to act swiftly and energetically in meeting unforeseen economic developments.

Monetary and Credit Policies and Economic Stability

The second major instrument of the Government for economic stabilization is monetary and credit policy, interpreted in the broadest sense to encompass all governmental actions affecting the liquidity of the economy and the availability and cost of credit. Here the Federal Government has broad and inescapable responsibilities, stemming basically from the sovereign right of Congress "to coin money, regulate the value thereof. . . ." The

Government's influence is exercised in several ways—principally through Federal Reserve control of the total volume of bank reserves, but also through Treasury management of the public debt and through the administration of a variety of government lending and credit guarantee programs. These powers can significantly affect the flow of funds into business investment, capital expenditures of State and local governments, residential construction, and purchases of consumer durable goods. Monetary and credit policies can be flexible, responding at short notice to changes in economic circumstances and prospects.

In an important sense, the private economy of the United States contains automatic or "built-in" monetary stabilizers. Unless the Government acts to make compensating changes in the monetary base, expansion of general economic activity, accompanied by increased demands for liquid balances and for investment funds, will tend to tighten interest rates and restrict the availability of credit. Similarly, a recession of business activity will normally lead to lower rates, easier terms, and less stringent rationing by lenders. Like fiscal stabilizers, the monetary stabilizers are often useful built-in defenses against recessions or against inflationary excesses of demand. But these defenses may not be strong enough. Being automatic stabilizers, they can only moderate unfavorable developments; they cannot prevent or reverse them. And at other times, unless the monetary authorities offset their effects, they can operate counter to basic policy objectives, braking expansions short of full employment. Discretionary policy is essential, sometimes to reinforce, sometimes to mitigate or overcome, the monetary consequences of short-run fluctuations of economic activity. In addition, discretionary policy must provide the base for expanding liquidity and credit in line with the growing production potential of the economy. For these reasons, the Federal Reserve System is continuously making and executing discretionary monetary policy.

The proper degree of general "tightness" or "easiness" of monetary policy, and the techniques by which the various governmental authorities can appropriately seek to achieve it, depend on the state of the domestic economy, on the fiscal policies of the Government, and on the international economic position. When the economy is in recession or beset by high unemployment and excess capacity, monetary policy should clearly be expansionary. How expansionary it should be depends very much upon the extent of the stimulus that the government budget is, and will be, giving to over-all demand. When demand is threatening to outrun the economy's production potential, monetary policy should be restrictive. How restrictive it should be depends, again, upon how much of the job of containing inflation is assumed by fiscal policy. There is, in principle, a variety of mixtures of fiscal and monetary policies which can accomplish a given stabilization objective. Choice among them depends upon other objectives and constraints. The relation of this choice to economic growth was noted above; the stabilization of demand at full employment levels by a budget surplus compensated by an expansionary monetary policy is favorable to growth. On the other hand, monetary policy may in some circumstances be constrained by the balance of payments. If low interest rates encourage foreign borrowing in the United States and a large outflow of funds seeking higher yields abroad, monetary policy may have to be more restrictive than domestic economic objectives alone would dictate. The first line of defense is to try to adapt the techniques of monetary control, so that policy can serve both masters at once. Even so, difficult decisions of balance between conflicting objectives may sometimes be unavoidable.

Monetary Policy and Debt Management

At the beginning of 1960, monetary policy was restrictive and interest rates were generally at postwar peaks. Despite bullish expectations about the economy, interest rates soon began a slow decline that lasted seven or eight months, aided by a gradual reversal of Federal Reserve policy (Table 8) beginning in March and furthered by the recession starting in May.

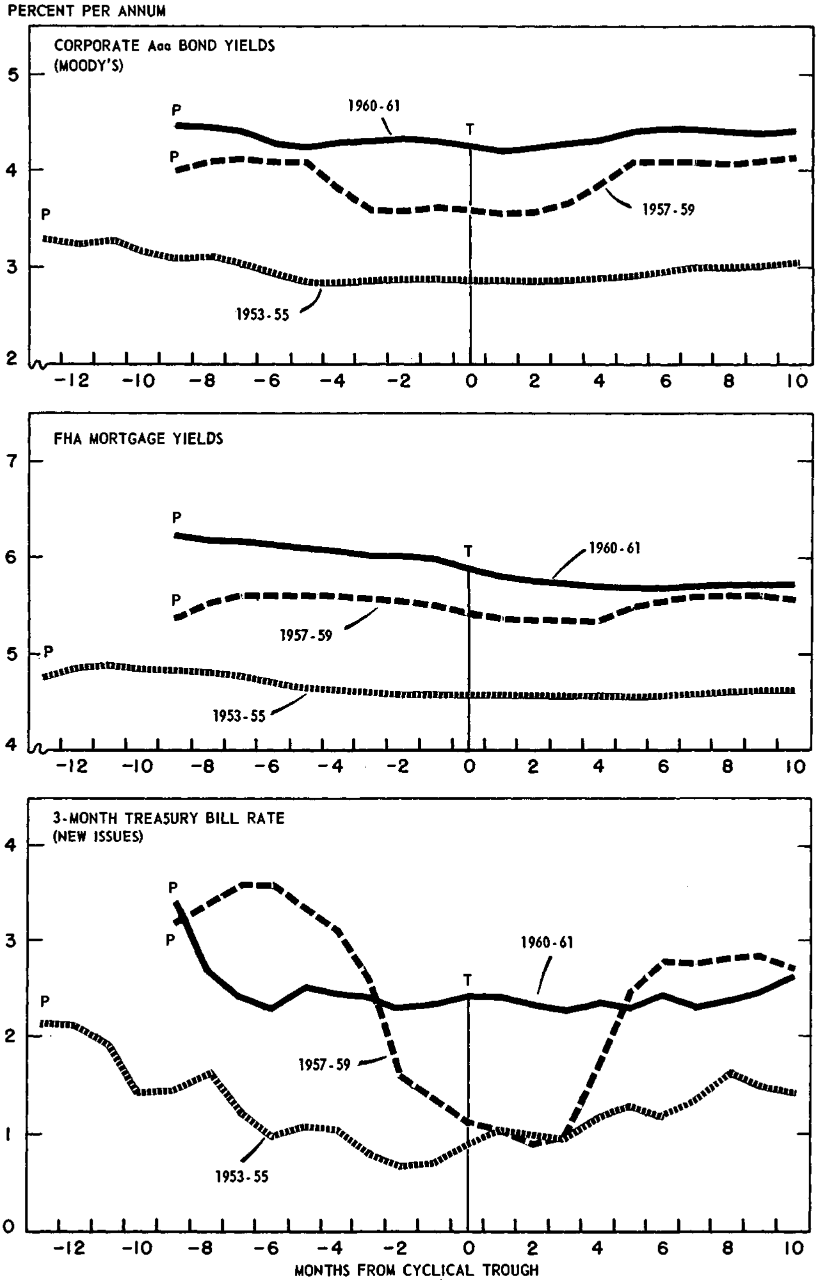
However, the Federal Reserve's anti-recession policy, for the first time since the early 1930's, was constrained by a serious balance of payments situation. Through its choice of expansionary monetary techniques, the Federal Reserve sought to avoid adding to the already large outflow of short-term capital. The 3-month Treasury bill rate did not fall below 2 percent. Long-term interest rates declined from their peaks but remained considerably above their previous cyclical troughs (Chart 8). This was a matter of serious concern because of the importance of long-term interest rates for business capital investment, residential construction, and State and local governmental spending on public facilities. And neither the money supply nor long-term private financing responded as promptly as in previous periods of monetary ease.

The new Administration faced in January 1961 both economic recession and a crisis of confidence in the dollar that threatened to limit sharply the use of expansionary monetary policy for economic recovery and growth. The Administration's forthright attack on the balance of payments problem restored confidence in the dollar. The resulting reduction in the discount on the dollar in the forward markets for foreign exchange eliminated any significant advantage in sending short-term funds abroad and helped to make it possible for monetary policy to support domestic expansion.

The ability of monetary policy to support economic expansion at home without stimulating outflows of short-term funds was simultaneously enhanced by new Federal Reserve open market techniques and by Treasurey debt management policies. In his Economic Message of February 2, the President had emphasized the importance of "increasing the flow of credit into the capital markets at declining long-term rates of interest to promote domestic recovery," while "checking declines in the short-term rates that directly affect the balance of payments." The Federal Reserve sold short-

CHART 8

Interest Rates in Three Business Cycles



NOTE: DATA ARE PLOTTED FROM CYCLICAL PEAK (P) TO 10 MONTHS AFTER CYCLICAL TROUGH (T).

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

TABLE 8.—*Principal Federal Reserve monetary actions, 1960–61*

Date	Action
1960: March	Federal Reserve open market operations modified so as to exert moderately less restraint on bank reserve positions than in earlier months. Effect was to allow reduction in net borrowed reserves.
May	Open market operations modified to provide reserves for moderate expansion of bank credit and money supply.
June	Discount rates reduced from 4 percent to 3½ percent.
July	Margin requirements reduced from 90 percent to 70 percent.
August	Authorized member banks to count about $500 million of vault cash as required reserves. Reduced reserve requirements against demand deposits at central reserve city banks from 18 percent to 17½ percent, effective September 1, releasing about $125 million of reserves.
August–September	Discount rates reduced from 3½ percent to 3 percent. Open market operations modified to suggest a positive attitude toward increasing the availability of reserves.
October	Purchased short-term U.S. Government securities other than Treasury bills for first time since 1958 to minimize downward pressure on 3-month bill rate, thus keeping bill rate more competitive internationally.
November–December	Authorized member banks to count all vault cash in meeting reserve requirements, reduced reserve requirements against demand deposits at central reserve city banks from 17½ percent to 16½ percent, raised requirements for country banks from 11 percent to 12 percent. Net effect of actions was to release about $1.3 billion of reserves.
1961: January–early February	Open market operations aimed at maintaining ease in member bank reserve positions, with seasonal increases in reserve funds about offset by gold outflow and other factors draining reserves.
February–December	On February 20, began providing reserves through purchases of longer-term U.S. Government securities, while selling short-term Government securities at times.[1] Expansion in money supply became more rapid later in the year, with monetary ease being maintained throughout the year.
December	Board of Governors announced increase in maximum rates payable on savings and other time deposits, effective January 1, 1962. The action was taken to promote competition for savings and to encourage retention of foreign funds by member banks and thus moderate pressures on this country's balance of payments.

[1] Treasury also purchased very long-term U.S. Government securities for Government investment accounts. In his Economic Message of February 2, President Kennedy had announced that the Federal Reserve and Treasury were developing techniques to help keep long-term rates down while holding short-term rates at internationally competitive levels.

Source: Council of Economic Advisers.

term securities, while the Treasury further increased the outstanding supply through new cash offerings. On February 20, the Federal Reserve announced a new policy of providing bank reserves through purchases of U.S. Government securities of longer maturities, particularly in the 3- to 6-year range. Its purchases of U.S. Government securities of maturity of more than 1 year amounted to $2.6 billion in 1961. The Treasury, in administering the investment portfolios of various government investment and trust accounts, made substantial purchases of securities of maturities of more than 10 years. Aided by these actions, long-term bond rates declined until May and rose only moderately thereafter in the face of an economic recovery that had begun in February.

Through substantial net purchases of U.S. Government securities, the Federal Reserve increased member bank reserves in 1961 by about $1 billion. As a result banks steadily expanded their loans and investments; the increase during the year was considerably more than in 1960 and about the same as in the peacetime record year, 1958. Persistently expecting an uptrend in market interest rates, banks maintained lending rates in the face of generally weak demands for short-term loans, and added $6 billion to their holdings of U.S. Government securities. However, the expansion of bank holdings of Government securities made more funds available on the open market. And the high level of bank holdings of short-term government securities, combined with abundant free reserves, put pressure on banks to expand business loans and to lend directly in the capital markets. As monetary ease persisted and expectations of rising interest rates subsided, banks stepped up purchases of State and local securities and expanded mortgage lending. The 7 percent increase in total bank deposits and currency during 1961 fell just short of the peacetime record, although public preference for time deposits held the increase in the money supply (demand deposits and currency) to about 3 percent.

The liquidity of the economy was also increased by changes in the composition and level of the Federal debt held outside the Federal Reserve and the Treasury. Open market and debt management operations added substantially to the supply of U.S. Government securities maturing within 1 year. The volume of less liquid securities, maturing within 1 to 5 years, declined. The volume of outstanding securities greater than 5 years in maturity remained the same. The average maturity of that part of the debt held outside the Federal Reserve and U.S. Government investment accounts declined from 58 months to 56 months. The average maturity of the total marketable public debt changed little in 1961. Two advance refundings, designed to have a minimal impact on over-all liquidity, helped to offset shortening as a result of mere passage of time.

Federal Reserve and Treasury debt operations provided the basic liquidity necessary for economic expansion. Individuals, in addition to increasing their deposits in commercial banks, stepped up their accumulation of claims on such financial intermediaries as savings and loan associations, mutual savings banks, and life insurance companies, while cutting down their purchases of securities on the open market. This behavior was in part a response to the high level of interest and dividend rates paid by financial intermediaries relative to yields of high-grade open market securities. Liquid assets held by the public—defined to include the money supply, savings deposits and shares, U.S. Savings bonds, and short-term U.S. Government securities—grew by 7 percent in 1961, paralleling the rise in GNP. Financial intermediaries used the funds which flowed into them from the public to extend credit by acquiring mortgages, bonds, and other loans and securities. In this way, their operations both increased the liquidity of individuals and made more long-term credit available.

The total volume of mortgage, corporate, and State and local long-term financing rose sharply to what appears to be a new record (Table 9).

TABLE 9.—*Funds raised in money and capital markets, by type of instrument, 1957–61*

[Billions of dollars]

Type of instrument	1957	1958	1959	1960	1961 [1]
Total	36.6	46.2	61.2	39.5	50.1
Federal obligations [2]	1.1	9.0	11.3	−2.2	6.6
Short-term [3]	5.5	−1.2	5.5	−5.1	10.5
Long-term [4]	−4.4	10.2	5.8	2.9	−3.9
Private	35.6	37.3	49.9	41.6	43.5
Short-term	7.4	5.3	16.9	13.4	9.8
Business bank loans	2.3	1.3	7.5	3.2	2.0
Consumer credit	2.8	.3	6.4	3.9	1.1
Other	2.3	3.7	3.0	6.3	6.7
Long-term	28.2	32.0	33.0	28.1	33.7
State and local securities	4.6	5.7	4.9	3.6	5.3
Corporate securities	9.8	8.2	6.5	6.9	7.9
Other securities [5]	1.7	2.8	2.5	2.2	2.4
Mortgages	12.1	15.3	19.2	15.4	18.1

[1] Preliminary estimates by Council of Economic Advisers.
[2] Excludes consumer-held savings bonds and notes issued to international organizations; includes nonguaranteed securities issued by Federal agencies.
[3] Direct marketable issues maturing in one year or less.
[4] Includes direct Treasury issues maturing after one year and all nonguaranteed securities.
[5] Investment company share issues and foreign security issues.

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

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

Corporations borrowed unusually heavily in long-term capital markets but added in the aggregate almost as much to their financial assets, of a generally liquid character, as to their financial liabilities. Monetary ease, in facilitating this financing, laid the financial groundwork for expanded corporate capital spending in the future.

Because of the expansion in liquidity and in the supply of credit through financial institutions, interest rates were relatively stable during 1961, in sharp contrast to the previous upswing (Chart 8). The rate of 3-month Treasury bills fluctuated within the narrow range of 2¼ and 2½ percent during most of the year, rising somewhat above this range toward the close. Most long-term rates declined through May and thereafter increased by only a small amount. Rates on home mortgages, which are more sticky than most other rates, continued to fall until midyear, and then remained fairly stable. Thus, 1961 has demonstrated that interest rates do not have to rise sharply in cyclical recoveries. Their movement is not governed by immutable natural law. It depends upon all economic circumstances and governmental policies affecting the supply of funds and the demand for them.

The behavior of interest rates during the year may also have signaled the ending of the upward trend in rates from the low levels at which they were pegged prior to the Treasury-Federal Reserve Accord of 1951. While this trend was in part an adjustment to the profitability of investment in capital goods, it also reflected the spread of inflationary expectations. Recent stability in industrial and consumer prices may, however, diminish inflationary psychology, so that inflation premiums would gradually be shaken out of the interest rate structure.

The climate for equity financing was also favorable during 1961. Common stock prices rose by about 25 percent, anticipating in part a recovery of corporate profits, and the average dividend yield on stocks fell below 3 percent.

Federal Credit Programs

The Administration sought to make credit readily available at liberal terms through programs of Federal lending and Federal insurance and guarantee of private lending. Important steps were taken to stimulate housing construction. Early in the year, the Federal Housing Administration (FHA) reduced the maximum permissible rate on insured mortgages in two steps, from 5¾ to 5¼ percent. The Federal National Mortgage Association (FNMA) supported these reductions by its secondary market operations in mortgages, raising both its purchase and selling prices repeatedly. Up to midyear, sales of mortgages by FNMA exceeded purchases, but after midyear its operations added to the supply of funds available for mortgages. The Federal Home Loan Bank Board and the regional Banks liberalized regulations and reduced interest rates on advances in order to stimulate mortgage lending by savings and loan associations.

For the longer run, the Housing Act of 1961 expanded or liberalized many existing credit programs and initiated new ones. A new FHA insurance program was set up for middle-income housing, with FNMA also prepared to purchase these mortgages under its special assistance programs. Maturities up to 35 years, in some cases up to 40 years, were authorized for FHA-insured mortgages and insurable loan-to-value ratios were increased. A new FHA program for insurance of long-term home improvement loans was instituted. FNMA made the new home improvement loans eligible for purchase under its secondary market operations, and, when used to finance rehabilitation of homes in urban renewal areas, the new loans are eligible for purchase by FNMA under its special assistance program. FNMA also was authorized to make short-term loans secured by federally underwritten mortgages. Funds were provided for loans for public facilities, college housing, farm housing, housing for the elderly, and FNMA special assistance. The capital grant authority for urban renewal was increased by $2 billion.

Other Federal credit programs contributed to making credit more generally available at liberal terms in 1961. In particular, the Small Business Administration reduced the interest rate on loans made in areas of substantial unemployment and instituted a simplified program to expand bank participation in small business loans.

Federal credit programs will support economic expansion during the coming fiscal year. New commitments are expected to rise to record levels. Direct loans and mortgage purchases (including trust fund purchases) will

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approach $9 billion, $3 billion more than anticipated collections on outstanding loans. New commitments to guarantee or insure private loans will for the first time reach $20 billion.

Monetary Expansion and Recovery

As the economy advances toward full employment, it will need more liquidity. Throughout the postwar period, and particularly in the three previous economic recoveries, the growth in liquidity has fallen considerably short of the growth in GNP. The economy had to work off the excess liquidity inherited from the war, interest rates were generally rising, and expectations of higher prices were spreading. These factors worked to reduce the liquidity requirements of the economy relative to GNP. And the growth in nonmonetary liquid assets diminished even more the needed growth in the money supply (bank deposits and currency). Business firms, government units, and individuals learned, to their advantage, how to minimize holdings of cash.

For each 1 percent rise in GNP in the three past economic recoveries, commercial bank deposits and currency increased by only about one-third of 1 percent, while liquid assets, more broadly measured, increased by about two-fifths to three-fifths of 1 percent. If these relationships should hold in the current economic recovery, and if gross national product rises to full employment levels by the middle of 1963—an increase of more than 20 percent from the trough in the first quarter of 1961—commercial bank deposits and currency would grow over the same period by 7–8 percent and liquid assets by 11–12 percent.

In the current recovery, however, the factors that served to limit liquidity requirements in the earlier recoveries may well be less important. In particular, interest rates may appropriately be more stable, for reasons already explained. Thus, these estimates of needed liquidity are probably conservative. The appropriate expansion of liquidity will depend upon the strength of private demands, on the tightness of fiscal policy, and on the balance of payments position.

Improving the Mobility of Resources

Maximum employment and production depend not only on the success of stabilization policy in maintaining demand at appropriate levels but also on the mobility of labor and other productive resources in response to changes in demand and cost. If frictional and structural unemployment can be diminished, demand can be pressed further before encountering bottlenecks and price increases. Thus, measures to improve the mobility of resources enable stabilization policy to aim at, and to attain, higher levels of employment and production. Such measures are a basic part of the Administration's economic program.

Labor Market Policies

Changes in technology and tastes are constantly altering the pattern of demand for labor in our economy. New industries appear and expand while old ones decline; job opportunities multiply in one region and disappear in another; new skills are required as old ones become obsolete. The more rapidly an economy grows and changes, the greater the flux in its labor markets.

A high level of over-all demand is a prerequisite for the efficient allocation of labor resources in a dynamic economy. It furnishes the most important single incentive for economically desirable labor mobility—the magnetic attraction of available job openings. However, a high level of demand will not by itself ensure the best possible degree of occupational, industrial, and geographic labor mobility, for it will not eliminate some important impediments to the desirable response of labor to job opportunities. Certain features of seniority, pension, and other benefit rights may serve to hold labor in industries and areas experiencing declining demand. Lack of knowledge of job openings and lack of the skills required to fill them constitute important barriers to labor mobility, and the high cost of moving is an insurmountable obstacle to the migration of many low-income families to areas of expanding employment. It is in the best interest of the economy, as well as of the individuals involved, that these impediments be reduced and that every wage earner be in a position to select the most favorable alternative from the widest possible range of employment opportunities.

Employment exchange. Letting employers know about available workers and telling workers about available jobs are difficult administrative and technical problems in a labor market as complex as ours. Yet doing this well can significantly reduce the number and size of labor shortages and help eliminate pockets of unemployment and underemployment.

A major effort has begun to improve the United States Employment Service so that it can do a better job in matching job vacancies with people. The staff has been substantially expanded, particularly in the metropolitan areas where most workers and jobs are concentrated. This staff will need, most importantly, to emphasize improvement in the quality of its counseling and placement work. The flow of information about jobs should be made nationwide through more extensive exchanges of job information among the State agencies. Also, since the performance of the important labor exchange function should not suffer from the tremendous administrative problems of administering unemployment compensation, these two activities should be separated where the volume of work permits.

As the United States Employment Service succeeds in improving its services, more people will use it. The larger the number of employers and workers using the Employment Service, the more complete will be the knowledge of the labor market available to each of them. A greatly strengthened United States Employment Service will facilitate an expanded rate of economic growth and contribute to the effectiveness of such specific government programs as Area Redevelopment, Rural Redevelopment, and the proposed programs for Trade Assistance and Manpower Development and Training.

Training. The economic need for facilitating labor mobility through education and training programs is evidenced by the simultaneous existence of very low unemployment rates in various skilled, technical and professional occupations and relatively high unemployment among the less skilled groups. Programs for education and training should be directed particularly toward new entrants into the labor force and the training of adults for positions of increased productivity and income. Racial discrimination in training, as well as in hiring, must be eliminated. It is wrong—that is reason enough—and it is also an enormous waste of human talent.

The Administration is proposing a program to provide useful employment and training for young people through three pilot programs financed in whole or in part by the Federal Government. These programs provide for on-the-job training, public service employment and training, and employment, training, and educational opportunities through service in a Youth Conservation Corps. Special training programs for young people are contemplated; such programs are urgently needed in urban slum areas. Some of these programs for the training of youth should help, directly and indirectly, to stimulate and guide the flow of migration from the farm; in April 1960, 43.8 percent of the entire farm population and 59.0 percent of the nonwhite farm population were under age 20.

Lack of education certainly does not imply lack of aptitude, and widened educational opportunities enable individuals to improve their employment opportunities as well as the quality of their lives. The Administration's program for aid to States and educational institutions in extending and improving adult literacy programs is an important step toward reducing structural unemployment.

The Administration's key proposal for manpower development and training provides for the establishment of programs for selection, placement, and on-the-job training, and for improvement of State training facilities. Although intended primarily for the unemployed and underemployed, these programs would also be open to other qualified persons desiring to improve their skills or to acquire new skills.

Compensation for workers participating in a training program is essential. At present, many individuals are confronted with the hard choice between compensation without training and training without compensation; the necessity for this choice should be eliminated. Unemployed workers in most States are still disqualified from receiving unemployment insurance benefits if they participate in education and training programs.

Moreover, workers receiving benefits are required to be continuously available for job placement. Compensation for training would make it financially possible for an unemployed individual to complete a full course of training or retraining. Under the proposed program, allowances would be provided for certain trainees not receiving unemployment compensation benefits. Thus a large part of the cost of trainee compensation under the program would be offset by reductions in unemployment compensation payments and various other public assistance expenditures.

A major feature of the proposal is the provision for government studies on a national and local basis to determine the future requirements of the economy for various occupations and skills, to anticipate prospective manpower shortages, and to assure that workers are trained for occupations where opportunities will exist.

Resource Use in Agriculture

The agricultural population has long been a major source of manpower for U.S. industry. Many more children are born and raised on farms than will be needed to produce the Nation's food and fiber. They must be educated, trained, and guided to nonagricultural employment. Many adults now earn substandard incomes in farming. They are not in a technical sense structurally unemployed, but their distress is nevertheless a symptom of structural maladjustment. Programs of the kind just discussed—to facilitate labor mobility and training—can and should help many of these individuals to find new employment.

During the first two decades of this century, there was serious question whether agriculture could, with the closing of the land frontier, continue to meet the food and fiber demands of a growing national economy. The rate of growth in farm output was declining, and food and fiber prices were rising relative to other wholesale prices. The resulting public concern led to (1) increased emphasis on conservation and resource investment and (2) increased allocation of public funds for research and education designed to speed progress in agricultural technology.

By the mid-1920's, agricultural productivity was rising and farm employment declining. The full implications of rapid technological progress in agriculture were, however, obscured by the depression and by the Second World War and the Korean conflict. During the depression, the catastrophic decline in demand for farm products was the compelling problem, and policy was directed to protecting farm prices and incomes from its consequences. During the war and the Korean conflict, government programs were designed to encourage increases in output and to protect farmers from the effects of price reductions when emergency demands disappeared.

During the 1950's, the full effects of the programs set in motion early in the century began to be felt. The demand for farm output rose only slightly faster than the population. Rapid gains in productivity put farm prices and incomes under increasing downward pressure. Farm programs designed for depression and war were continued, in order to hold at least part of the social gains from increasing agricultural productivity within the agricultural sector. Farmers also responded by leaving agriculture at the most rapid rate in history. Use of labor declined by almost one-third while output increased by more than one-fourth between 1950 and 1961.

By 1960, it was clear that agriculture's relationship to the general economy had undergone a fundamental change in several respects. Agriculture can, without question, meet any foreseeable demands for food and fiber placed upon it. In 1910, it required 13.6 million farm workers to feed a Nation of 92.4 million people. By 1960, the population had increased to 180.7 million and farm employment had fallen to 7.1 million. The effects of fluctuations in national economic activity on the demand for farm output have been damped by built-in floors under consumer spending and by continuation of the emergency farm programs. Nevertheless, the stability and growth of the national economy are still of great importance to the farm population. Failure to maintain full employment limits the ability of industry to absorb farm workers displaced by advancing technology. During periods of peak economic activity, migration has been above 5 percent of the farm population. During recessions in the last decade, the migration rate out of agriculture has fallen considerably. Thus the problem of agricultural labor mobility is very largely a question of the availability of nonagricultural job opportunities. If job opportunities are available, the general manpower policies discussed above can facilitate the necessary migration and ease the human problems of adjustment.

Caught between the pressures of a slowly rising demand for farm products, rising productivity in agriculture, and limitations on nonfarm employment opportunities, total farm income and farm income per capita or per farm family have lagged behind incomes in the rest of the economy. The commodity programs have protected farm incomes from even greater declines, but at considerable budgetary expense and at some cost in delaying adjustment of patterns of resource use in agriculture. In 1961, farm incomes were increased and a significant start was made toward reduction of costs of surplus accumulation, storage, and disposal.

Objectives of agricultural policy as it develops in the future should encompass both (1) continuation of agriculture's historic role as a major contributor to national economic growth and (2) equitable distribution of gains in agricultural productivity between farmers and consumers. Achievement of these two objectives will require continued rapid transfers of labor from the farm to the nonfarm sector and reduction in resources devoted to the production, storage, and disposition of surplus production.

Appendix

Program for Economic Recovery and Growth

When the new Administration took office on January 20, 1961, it moved with speed and vigor to deal with the recession that had begun in May 1960. At his press conference of February 1, the President announced a series of administrative actions. He followed this with a comprehensive "Program to Restore Momentum to the American Economy," delivered before the Congress on February 2. Legislative requests, some of them directed toward the immediate situation, others toward future recovery and growth, were laid before the Congress in this speech and in a series of messages during the year.

The following is a list of the actions taken during 1961 to foster economic recovery and growth. Included also are measures (other than defense and foreign aid) which, though primarily directed to other purposes, contributed significantly to growth.

A. Executive and Administrative Actions

1. *Accelerated Procurement and Construction*

The President directed Federal agencies to accelerate procurement and construction planned for the rest of fiscal year 1961 under existing funds.

2. *Post Office Construction*

It was announced that post office construction, originally scheduled for implementation over 18 months, would be compressed into 10 months (March to the end of the calendar year). Although changes were made in this directive before the end of the calendar year, there was a substantial acceleration during the first half of 1961 in the provision of new offices. Projects for post offices were concentrated in areas of high unemployment.

3. *Federal-Aid Highways, School and Other Construction*

On February 2, the President made available $718 million of Federal-aid highway funds scheduled for release in the fourth quarter of fiscal 1961. Quarterly apportionments for the first and second quarters of fiscal 1962 were also released ahead of schedule, in May and August. On February 16, the President urged State Governors to speed the spending of $1.1 billion in Federal aid for highways, schools, hospitals, and waste treatment facilities.

4. *Accelerated Tax Refunds*

Taxpayers who were eligible for refunds were requested to file returns early to speed refund payments. In the first three months of 1961, individual income tax refunds totaled about $2.1 billion, 31 percent more than in 1960.

5. *Veterans Life Insurance Dividends*

On February 1, the President announced that he had directed the Veterans Administration to advance the payment of veterans life insurance dividends. The total payable, $258 million, over the entire calendar year was made available in the first quarter. In addition, a special dividend payment of $218 million was made in late June and in July.

6. *Price Supports and Farm Storage Payments*

Price supports were raised on corn, cotton, butterfat and milk, soybeans, and most other price-supported commodities for the 1961 crop year.

On February 8, the President directed the Department of Agriculture to speed payments to farmers for storage of crops under price support loans. The payments, advanced to early March, amounted to about $25 million.

7. *Food Distribution*

In his first executive order, the President, on January 21, directed the Secretary of Agriculture to expand the free food distribution program for needy families in areas of chronic unemployment. On January 24, the Secretary of Agriculture announced that, through additional purchases of protein foods, the Government would increase the variety of surplus foods being distributed. As a result of these actions, the annual rate of distribution was raised from about $60 million to more than $200 million.

8. *Food Stamp Program*

On February 2, the President announced the establishment of six area projects for operation of a pilot "food stamp" distribution program. This was subsequently expanded to eight areas.

9. *Farm Loans*

On February 8, the Department of Agriculture announced that, pursuant to a White House directive, it was making available an additional $50 million for housing loans to low-income farmers. On February 13, the Department announced that the Farmers Home Administration would release an additional $35 million for operating loans for farmers. Lending activity of the Farmers Home Administration for rural area development was accelerated.

10. *Rural Electrification Administration*

During the year, the Rural Electrification Administration intensified its activity in the field of rural area development.

11. *Monetary Policy and Debt Management*

As the President announced in his February 2 message, the Federal Reserve and the Treasury Department worked "to further the complementary effectiveness of debt management and monetary policy." During the year, their policies were directed toward fostering domestic economic recovery by providing the base for needed bank credit and monetary expansion and by encouraging the flow of savings and credit into long-term investment channels. The Federal Reserve provided bank reserves through purchases of securities of more than 1 year. The Treasury Department has been buying long-term U.S. Government securities for the trust fund accounts. At the same time, both monetary and debt management policies countered downward pressure on short-term rates, with a view to checking the outflow of funds from this country to money markets abroad.

12. *Housing Actions*

On February 1, the President announced a speeding up of the initiation of projects already approved (including the commitment of available college housing funds ahead of schedule).

On February 2, the maximum permissible interest rate on insured home loans of the Federal Housing Administration (FHA) was reduced from 5¾ percent to 5½ percent, and on May 29 to 5¼ percent.

The Community Facilities Administration reduced rates on new loans and broadened the program to include certain communities and projects previously excluded.

Purchase and sales prices for federally underwritten mortgages under Federal National Mortgage Association (FNMA) secondary market operations were raised in a series of steps. After the middle of 1961, purchases of mortgages by FNMA under secondary market operations exceeded sales.

The Federal Home Loan Bank Board liberalized terms under which Federal savings and loan associations can make mortgage loans; broadened the powers of insured associations to engage in participation loans; allowed member associations to borrow an amount up to 17½ percent of withdrawable accounts from Federal Home Loan Banks, in contrast to the former 12½ percent (this action was taken in two steps); caused Federal Home Loan Banks to reduce interest rates on advances to members; and instituted a new program of intermediate advances by Federal Home Loan Banks.

On February 2, the Urban Renewal Administration requested local public agencies to accelerate urban renewal activities.

On July 17, FHA eliminated the continuing service charge formerly permitted for home mortgages of $9,000 or less.

13. *Small Business Administration Loans*

On April 5, the Small Business Administration (SBA) announced a decrease from 5½ percent to 4 percent in the interest rate on loans to small businesses in areas of substantial unemployment, and a liberalization of size standards. The Agency also reduced from 5–5½ percent to 4 percent the interest rate on loans to State and local development companies in such areas. In August, it instituted a simplified bank loan participation plan designed to achieve expanded commercial bank participation in small business loans.

14. *Government Procurement in Areas of Substantial Unemployment*

On February 2, the President announced that he was directing the Secretary of Defense, Secretary of Labor, and the General Services Administration to take steps to improve the mechanism for channeling Federal contracts to firms both in areas of substantial unemployment and in areas of substantial and persistent unemployment. Accordingly, the Federal Procurement Regulations have been amended (1) to provide procedures for the setting aside of appropriate procurements for award to firms which will perform a substantial proportion of the contracts in areas of substantial unemployment and areas of substantial and persistent unemployment, (2) to assure that concerns in such areas are afforded an equitable opportunity to compete for subcontracts under government prime contracts, and (3) to clarify and strengthen the preference for firms in such areas in procurements where equal low bids are received. Similar instructions have been issued in the Armed Services Procurement Regulation.

15. *United States Employment Service (USES)*

On February 2, the President directed the Secretary of Labor to expand and improve services to jobless applicants registered with the USES. Placement services, especially in metropolitan areas, have been realigned to meet the needs of workers and employers in all occupations. The Bureau of Employment Security and affiliated State agencies have increased program emphasis on job development for the unemployed, and testing, counseling, and placement activities for young people out of school and out of work.

16. *Manpower Retraining*

In anticipation of passage of the proposed manpower development and training act, the Secretary of Labor on November 27 requested all States to develop plans for immediate implementation of the law. In addition, the Department of Labor and the Department of Health, Education, and Welfare have coordinated plans for effectively carrying out their responsibilities under the act.

17. *Export-Import Bank*

The Export-Import Bank announced two new programs which make available export credit guarantees, insurance and financing for semifinished and consumer durable goods, and export credit insurance for consumer goods. The first of these makes available export credit insurance, covering both political and credit risks on short-term and medium-term credit sales, which will be issued through a private association of insurance companies. The second program consists of guarantees issued to financial institutions and Bank participation with financial institutions which finance exporters' medium-term credit sales on a nonrecourse basis. Both programs are designed to enable the exporter to apply for assistance directly to his local commercial bank or insurance broker.

B. Legislative Recommendations and Actions

1. *Temporary Extended Unemployment Compensation*

The President requested the Congress to increase temporarily the period during which unemployment insurance benefits might be paid. The Congress enacted this proposal. The legislation establishes, on a self-supporting basis, a temporary program of extended unemployment compensation to persons who have exhausted their benefits under State and Federal laws. It provides for agreements with States to pay temporary extended unemployment benefits, for any worker who exhausts his State benefits between June 30, 1960 and March 31, 1962, equal to 50 percent of the amount received in State unemployment benefits or 13 times his weekly benefit amount. The increases in benefits are being financed by an increase of 0.4 percent in the unemployment tax rate for the calendar years 1962 and 1963.

In addition, the Congress authorized a temporary self-supporting program of extended railroad unemployment insurance to workers who have exhausted normal benefits under the Railroad Unemployment Insurance Act.

2. *Unemployment Compensation*

The President, on June 13, proposed major changes in the Federal-State unemployment compensation system. The Administration bill, introduced in the First Session of the 87th Congress, would extend the scope of the system by increasing coverage to include over three million more workers; increase benefits so that a great majority of eligible claimants would receive a weekly benefit equal to at least one-half of their average weekly wage; establish a permanent Federal program of additional compensation for unemployed workers who have exhausted their regular benefits; and improve the financing of the program by increasing the wage base on which the unemployment tax is based from $3,000 to $4,800.

In addition, the measure includes equalization grants to States with high unemployment costs, and a provision precluding denial of unemployment compensation to claimants who are attending approved training or retraining courses.

The Congress took no action on the Administration bill in 1961.

3. *Aid to Dependent Children*

The Congress was requested to extend the program of aid to dependent children by providing benefits to children who are needy because of the unemployment of their parents. A bill was passed by the Congress and signed by the President on May 8. It is estimated that expenditures of about $100 million in fiscal 1962 are being made under this program.

4. *Social Security Liberalization*

The President proposed legislation to improve the old age, survivors, and disability insurance and public assistance programs. Such legislation was passed by the Congress and approved by the President on June 30 to provide, among other things, increased minimum social security benefits, an earlier retirement age for men, and increased benefits for widows. To meet the increased benefit costs the Federal Insurance Contribution Act taxes were increased, effective January 1, 1962, by one-eighth of 1 percent each on employers and employees.

5. *Manpower Retraining*

The President proposed a manpower development and training program, providing for counseling, training, relocation assistance, and vocational education. The Administration's bill provides for retraining unemployed persons who cannot reasonably be expected to secure full-time employment without retraining and for upgrading the skills of other members of the work force. It also provides for continuing review and assessment of the Nation's manpower requirements, for appropriate methods of testing, counseling, and selecting workers for training, for determining the skills in which they should be trained, for referral of workers for training, for placement services after completion of training, and for financial assistance during the training period for those unemployed workers who cannot undertake a training program without it.

The Senate approved a manpower retraining bill, and a bill was reported out by the House Education and Labor Committee. The House Rules Committee postponed giving a rule for debate on the bill until 1962.

6. *Youth Employment Opportunities*

The President recommended the enactment of a Youth Employment Opportunities bill. The proposal includes on-the-job training programs conducted in cooperation with both private and public groups, public service employment programs established in cooperation with State and local public and nonprofit agencies, and a Youth Conservation Corps which would perform conservation and related work pursuant to agreements with State and Federal conservation agencies.

Both Senate and House Committees reported out bills on the subject in 1961, but no further action was taken.

7. *Minimum Wage*

The President signed the Fair Labor Standards Act Amendments on May 5, extending coverage to approximately 3.6 million additional workers and increasing the minimum wage to $1.25 an hour over a period of time. The amendments represent the first Congressional action on extension of coverage since the Act was passed in 1938.

8. *Area Redevelopment*

The Administration proposal to aid areas with substantial and persistent unemployment was enacted and signed by the President on May 1. The

Area Redevelopment Act provides loans to commercial and industrial enterprises, loans and grants for community facilities and urban renewal, all designed to increase employment opportunities in these areas. In addition, the Act provides for the training and retraining of unemployed and underemployed residents of these areas and for the payment of retraining subsistence benefits while in training.

In 1961, 359 redevelopment areas and 9 Indian Reservations prepared and submitted plans for their over-all economic development. Of these, plans covering 247 redevelopment areas and 9 Indian Reservations had been given provisional approval by the end of the year. Eleven projects involving industrial loans, grants and loans for public facilities, and technical assistance contracts were approved. Sixty-six more were under active consideration at the end of the year.

Occupational training programs for unemployed and underemployed persons were initiated in October 1961, under the provisions of the Area Redevelopment Act. As of January 5, 1962, training projects in 17 redevelopment areas located in 7 different States had been approved. These projects provided for the training of 3,500 workers in 45 courses of instruction. Fifty training proposals from as many areas are under active consideration, and an additional 50 are in various stages of preparation in local communities.

9. *Housing*

A Presidential message sent to the Congress on March 9 included the following proposals: a 4-year commitment of $2.5 billion for urban renewal; long-term, low-interest loans for nonprofit limited dividend rental and cooperative housing for moderate income families financed by special assistance from FNMA; expanded public housing and housing for the elderly; authority for FHA to insure long-term home improvement loans; additional aid for urban planning, community facilities, and housing research; an extension of the FHA insurance program for middle-income families to permit in certain cases a 40-year maximum mortgage period, to remove the downpayment requirement, and to make other changes to ease housing credit.

The Housing Act of 1961, incorporating the substance of these proposals, was approved on June 30.

The veterans home loan program was extended by legislation approved on July 6.

10. *Feed Grains Program*

The President signed an emergency feed grains bill on March 22. It authorized the Secretary of Agriculture to make payments to growers on 1961 crops to reduce acreage and output, and to increase support prices for feed grains. Advance payments were begun shortly after the bill was signed.

11. *Agriculture*

The President sent to the Congress an omnibus farm bill on March 16. A bill signed into law on August 8 extended and liberalized lending programs of the Farmers Home Administration, extended the emergency feed grains program to 1962 crops, authorized a program of payments to producers for reducing wheat acreage in 1962, extended the special milk program and the National Wool Act for 4 years, extended the program for the sale of surplus commodities for foreign currency for 3 years, and authorized marketing orders for additional commodities.

12. *Federal-Aid Highways*

The President, in a message sent to the Congress on February 28, recommended increased taxes and a schedule of authorizations which would permit completion of the Interstate System in 1972 and an expansion of other Federal-aid highway programs. The Federal-Aid Highway Act of 1961, approved on June 29, provides increased authorization and revenues required to permit completion of the Interstate System by 1972, while maintaining the pay-as-you-build principle.

13. *Natural Resources*

A Presidential message sent to the Congress on February 23 included a program calling for increased aid for waste treatment facilities and air pollution, expansion of the saline water program, accelerated forest planting, access roads to public forests, purchase of shoreline areas for park sites, and a 10-year program of grants to the States for planning comprehensive water development projects. On July 20, the President signed a bill almost doubling grants for water pollution control and strengthening federal authority to seek abatement of pollution. On September 22, an extension of the saline water program for 6 years was approved, with an authorization of $75 million. To carry out the President's forestry program, appropriations for the Forest Service were substantially increased with particular emphasis on the expanded reforestation program, acceleration of recreational facility development, and strengthening protection against forest fires. Authorization for the Cape Cod National Seashore was signed into law on August 7. In the Housing Act of 1961, approved on June 30, partial grants to localities in an aggregate amount of $50 million were authorized for the acquisition of land for permanent open space in or near urban areas.

14. *Airport Aid*

Administration bills authorizing construction grants of $75 million a year for 5 years were introduced in both the Senate and the House. A bill signed on September 20 authorized the extension of Federal construction grants to airports for 3 years. A 2-year grant of $150 million was included in the final money bill approved on September 27.

15. *Aid to Education*

The President sent a special message on education to the Congress on February 20. It included recommendations concerning elementary and secondary schools and higher education.

Elementary and secondary schools: The President recommended that the Congress authorize a 3-year program for school construction and teachers' salaries. The total cost would be $2.3 billion. The Senate passed a school aid program, but the House Rules Committee tabled the proposal.

Higher education: Legislation was proposed to provide more than $3 billion in assistance to higher education. The proposals included the extension and expansion of the low-interest loan program for college housing facilities; authorization of a new 5-year program under which $300 million would be loaned each year for the construction of academic facilities; authorization of a program of 4-year undergraduate scholarships; expanded student loans and fellowships through the National Defense Education Act.

The Administration supported legislation to provide matching grants for establishment of educational television stations and for State surveys of the need for such stations. The Senate passed a bill to authorize aid for establishment of such stations and the House reported a bill out of Committee which was substantially the same as the program submitted.

As part of the Housing Bill signed on June 30, the college housing fund was increased from $1.7 billion to $2.9 billion in four steps by July 1, 1964.

The National Defense Education Act was extended for two years on October 5, continuing the previous $90 million annual authorization for student loans.

16. *Health Programs*

A Presidential message sent to the Congress on February 9 included the following proposals:

(1) Increased grants for the construction of nursing homes; grants to States for community health programs, and project grants to develop new methods of out-of-hospital care; increased project grants for research into uses of medical facilities, including grants for the construction of experimental and demonstration facilities;

(2) A 10-year program of matching grants for the construction, expansion, and restoration of medical and dental schools with an authorization of $75 million a year and an anticipated first-year appropriation of $25 million;

(3) Authorization of Federal grants to schools for scholarships for medical and dental students;

(4) Increased appropriations for existing maternal and child welfare programs;

(5) Increased vocational rehabilitation grants;

(6) An extended and expanded program of matching grants for the construction of research facilities and increased appropriations for the

medical research and training programs of the National Institutes of Health.

The community health services and facilities bill, approved on September 20, increased from $30 million to $50 million the annual authorization for grants to States for public health services (with particular attention to community health service programs); authorized an additional $10 million a year for project grants to develop new methods of out-of-hospital care; raised from $10 million to $20 million the annual authorization for grants to build public or nonprofit nursing homes; and increased from $1.2 million to $10 million the authorization for research into uses of medical facilities (including construction of experimental facilities).

17. *Medical Care for the Aged*

The President recommended a health insurance program for those of age 65 or over who are eligible for Social Security benefits. The insurance would be financed by an increase in Social Security payroll taxes. Hospital and home health service benefits would begin October 1, 1962. Nursing home service benefits would begin July 1, 1963. Action by the Congress was postponed.

18. *Tax Recommendations*

Among his tax recommendations, the President asked for the enactment of an investment tax credit as an incentive for the modernization and expansion of private plant and equipment. He also recommended withholding taxes on interest and dividends and a series of measures to eliminate defects and inequities. This tax program would involve no net loss in revenue. On August 23, the House Ways and Means Committee announced that it was postponing further action until 1962.

19. *Special Insurance Dividend for Korean Conflict Veterans*

On September 13, the President approved a measure authorizing a one-time special dividend on the otherwise nonparticipating insurance issued to veterans of the Korean conflict. The dividend declaration amounted to $56 million of which approximately $30 million was disbursed to eligible policyholders by the end of calendar year 1961.

20. *Small Business Administration (SBA)*

Legislative action during 1961 liberalized the Small Business Investment Program and expanded and strengthened the activities of the Small Business Administration. Additional private capital was attracted into small business investment corporations by amendment of the Small Business Investment Act, which increased the maximum amount of Government participation in a single corporation from the previous limit of $150,000 to $400,000. The ability of the SBA to lend to State and local development corporations was also increased. Amendment of the Small Business Act provided for the development of a program to assure small business participation in subcontracts relating to government procurement, and broadened the authority for research and counseling services for small business.