Alternatives and Issues
In Federal Fiscal Policy

Tax Foundation, Inc., 50 Rockefeller Plaza
New York, N. Y. 10020
Foreword

Recent months have seen an unparalleled debate over counter-cyclical fiscal and monetary measures. Discussion has focused on such questions as the adequacy of statistical information on the state of the economy, the degree of restraint needed to check inflationary pressures, the kind of measures that are appropriate under present circumstances, the relative advantages of tax measures, government expenditure controls, monetary restraint, voluntary restraint, and control by "guidelines."

The purpose of this handbook is to provide a background of information and analysis that would be useful to the layman who is serious about examining the issues involved. Intelligent alternatives should be developed and discussed. Moreover, a better informed public is a necessary requirement for the success of whatever policies are chosen for purposes of economic stability and growth, since better performance of the economy depends essentially on what happens in the private sector.

This publication went to press just before the presentation of the U.S. Budget for the fiscal year 1968. Since the purpose of the handbook is to provide background rather than conclusions on current issues, no attempt has been made to revise data or text in the light of new Presidential proposals.

George A. Bishop, Director, Federal Affairs Research, had primary responsibility for drafting this study.

The Tax Foundation is a private, non-profit organization founded in 1937 to engage in non-partisan research and public education on the fiscal and management aspects of government. It serves as a national information agency for individuals and organizations concerned with government fiscal problems.

TAX FOUNDATION, INC.
December 1966
Table of Contents

I. INTRODUCTION ............................................. 5

II. BACKGROUND ON FISCAL POLICY................................. 6
    Employment Act of 1946 ................................... 6
    Objectives ............................................... 6
    Framework of Policy Formation .............................. 6
    Relations Among Major Government Agencies ................ 7
    Implementation of Policy .................................. 8
    The Instruments of Policy .................................. 8
    Role of Fiscal Policy Since World War II .................. 10
    Recent Episodes in Fiscal Policy ............................ 10

III. CURRENT ISSUES IN FISCAL POLICY...................... 29
    Economic Issues .......................................... 29
    Major Fiscal Objectives and Other National Policy Goals .... 29
    Conflicts Among Major Economic Goals ....................... 31
    Alternative Means to Given Goals .......................... 33
    Measuring the Economic Situation ........................... 39
    Political Issues ......................................... 41
    Coordination of Policies ................................... 41
    Representation of Different Viewpoints in Policy Formation . 45

IV. CONCLUDING OBSERVATIONS: ROLE OF GOVERNMENT IN THE ECONOMY .... 47

APPENDIX I EXCERPTS ON FISCAL POLICY FROM THE PRESIDENT'S BUDGET MESSAGES, 1955-1966 ............. 49

APPENDIX II EXCERPTS ON FISCAL POLICY FROM ECONOMIC REPORTS OF THE PRESIDENT, 1956-1968 ............ 58

List of Tables and Charts

Table
1. Comparison of Original Federal Budget Estimates with Actual Receipts, Expenditures, and Surplus or Deficit, Fiscal Years 1947-1966 ............... 11
2. Original Estimates of Surpluses or Deficits in the Administrative and Cash Budgets Compared with Actuals, Fiscal Years 1956-1958 ............... 15
3. Original Estimates of Surpluses or Deficits in the Administrative and Cash Budgets Compared with Actuals, Fiscal Years 1959-1961 ............... 18
4. Original Estimates of Surpluses or Deficits in the Administrative and Cash Budgets Compared with Actuals, Fiscal Years 1962-1966 ............... 25
5. Comparison of Original Federal "Cash Budget" Estimates with Actual Receipts from, Payments to the Public, and Surplus or Deficit, Fiscal Years 1955-1966 ............... 27
6. Federal Executive Branch Forecasts of GNP for Budget and Fiscal Policy Purposes Compared with Actual GNP, Calendar Years 1955-1968 ............... 40

Chart
1. Federal Cash Payments to and Receipts from the Public, Cash Budget Surplus or Deficit, and Surplus or Deficit in The National Income Accounts, Quarterly 1948-1965 ......................... 12
2. Selected Short and Long-Term Interest Rates, Monthly 1948-1966 ............... 14
4. Index of Industrial Production, Gross National Product in Current and Constant Dollars, Quarterly 1948-1966 ......................... 19
5. Total Employment, Unemployment Rate, and Help-Wanted Advertising, Monthly 1948-1966 ......................... 20
Questions of fiscal policy have aroused widespread interest recently because of the effects of the Revenue Act of 1964 in stimulating the economy and reducing unemployment, as well, it appears, as contributing to inflation. The increase in defense expenditures as a result of the war in Vietnam touched off further debate on the kinds of policies needed to contain inflationary pressures.

The 1966 setting for fiscal policy decisions was one in which the Administration embarked on many new programs aimed at a variety of social and economic goals at the same time that defense needs were rising. The near monopoly of front-page news by governmental actions and policies has tended to obscure the significance and performance of the private sector of the economy. The private sector accounts for about four-fifths of national output (measured in terms of purchases of goods and services). In the rush to develop a governmental program to meet more and more social "needs," are we not in danger of neglecting basic issues of how governmental policies and actions affect the operation of the private sector and the values of individual freedom and decentralized centers of initiative that are essential characteristics of our society?

Fiscal policy, as it is currently being formulated, concentrates on the "grand aggregates" of the economy: total output (as measured by the gross national product) total employment, total unemployment, the general level of prices. The performance of the economy is examined in terms of the relation of current output to "potential output" — again as measured by the actual GNP and an estimate of what GNP would be at "full employment."

The term "fiscal policy" usually refers to the deliberate manipulation of the effects of Federal taxing, spending, and borrowing on the national aggregates of output, employment, and price levels. The term "monetary policy" usually refers to the actions taken by the Federal Reserve Board to influence the total supply of money (defined most often as currency in circulation plus demand deposits, but also more broadly to include time deposits as well).

Looking at the economy in such terms involves a considerable degree of simplification. Various assumptions are made or implied about the workings of the parts of the economy. Yet many important issues are involved in the relations between the aggregates and the parts, and these relations tend to be neglected in fiscal policy discussions.

The purpose of this handbook is to examine, in reasonably brief space, both issues concerning economic aggregates, in the context of the assumptions usually made by economists, and issues of the relation of the parts to the whole.

In addition to economic elements, some major administrative and political issues are examined. The administrative issues considered relate to the role of the Council of Economic Advisers and to the role of Congress in fiscal policy making.
II. Background on Fiscal Policy

The Employment Act of 1946 was one result of the disastrous experiences of the 1930's. During World War II debate continued on what kind of policies were needed to prevent another such depression once peace returned.

The Employment Act, after going through many changes of form and substance,\(^1\) accomplished two significant beginnings: (1) it set out a general statement of economic objectives, and (2) it established certain administrative and legislative procedures for the formulation, discussion, and implementation of fiscal policies.

**EMPLOYMENT ACT OF 1946**

**Objectives**

In one lengthy sentence, the Act set out objectives with qualifications as follows:

... it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with ... other essential considerations of national policy ...

to coordinate and utilize all its plans, functions, and resources

for the purposes of creating and maintaining, in manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded

useful employment opportunities, including self-employment, for those able, willing, and seeking to work,

and to promote maximum employment, production, and purchasing power.

The meaning and background of this statement of objectives were elaborated and explained in the First Annual Report to the President by the Council of Economic Advisers, December 1946. Every Annual Report of the Council of Economic Advisers (CEA) since that time has in some measure reinterpreted the broad phrases of the Employment Act in applying its directives to the current situation.

**Framework for Policy Formation**

The Employment Act requires that the President send to Congress at the beginning of each session an Economic Report setting forth:

... (1) the levels of employment, production and purchasing power ... in the United States and such levels needed to carry out the policy declared ...

(2) current and foreseeable trends in the levels of employment, production and purchasing power;

(3) a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States ... ;

and

(4) a program for carrying out the policy declared [in this Act] ... as he may deem necessary or desirable.

To advise and assist the President in making his annual Economic Report, the Act established a Council of Eco-

---

omic Advisers, consisting of three econ-
omists aided by a professional staff.

To assist in Congressional considera-
tion of the analysis and recommenda-
tions in the Economic Report of the
President, the Act established a “Joint
Committee of Congress on the Eco-
nomic Report.” This cumbersome name
was later changed to the “Joint Eco-
nomic Committee of Congress.” The
Committee is composed of seven mem-
bers of the Senate and seven members
of the House of Representatives. Its
functions are as follows:

(1) to make a continuing study of
matters relating to the Economic Re-
port;

(2) to study means of coordinating
programs in order to further the policy
of this Act; and

(3) as a guide to the several commit-
tees of the Congress dealing with legis-
lation relating to the Economic Report,
not later than May 1 of each year to
file a report with the Senate and the
House of Representatives containing
its findings and recommendations with
respect to each of the main recom-
mendations made by the President in
the Economic Report, and from time
to time to make such other reports and
recommendations to the Senate and
House of Representatives as it deems
advisable.

The Joint Economic Committee has a
staff of professional economists to assist
it in its functions and to make studies re-
lating to the Economic Report. The
Committee has held annual hearings on
the Economic Report and special hear-
ings on selected economic problems. It
has published many reports in addition
to its annual report and numerous studies
done by its staff and by outside con-
sultants.  

Relations Among Major
Government Agencies

Among the “duties and functions” as-
signed to the Council by the Employ-
ment Act was the following:

. . . to appraise the various programs
and activities of the Federal Govern-
ment in the light of the policy declared
. . . and to make recommendations to
the President with respect thereto . . .

In exercising its powers and functions,
the Council was directed to:

. . . constitute such advisory commit-
tees . . . of industry, agriculture, labor,
consumers, State and local govern-
ments, and other groups, as it deems
advisable;

[and] . . . to the fullest extent possible,
utilize the services, facilities, and in-
formation of other Government agen-
cies as well as of private research
agencies, in order that duplication of
effort and expense may be avoided.

It may appear odd at this date that no
explicit reference was made in the Em-
ployment Act to the Federal Reserve
System or to monetary policy. This omis-
sion was in part a result of the wide-
spread opinion of the time, based to
some degree on the experience of the
1930’s, that monetary policy was ineffec-
tive in preventing depressions or in
stimulating employment. It must also be
remembered that the framers of the Em-
ployment Act of 1946 were expecting
that the postwar problem would again
be one of preventing depression rather
than of checking inflation.  

2. U.S. Congress, Joint Economic Committee, Publications of the Joint Economic Committee, January 1947-

3. Another contributing influence was the fact that during World War II, a policy of maintaining low interest
rates was followed and then pursued for some time after the war. This policy effectively prevented the
monetary authorities from applying restrictive measures—as long as interest rates were “pegged” com-
mercial banks were free to obtain additional reserves by selling government securities. The Federal Reserve
System necessarily had to buy government securities to prevent their prices from dropping. It was not until
the “Accord” between the Treasury Department and the Federal Reserve System in 1951 that monetary
policy became an effective stabilization weapon.
No explicit reference was made either to the Treasury Department or the Bureau of the Budget. However, as noted later, close working relationships have developed among these agencies and others.

**Implementation of Policy**

A former Chairman of the Council of Economic Advisers has remarked that, "As befits a constitution, the Employment Act lays down general principles and procedures, but gives little guidance on how the Federal government is to discharge its new responsibility of promoting 'maximum employment, production, and purchasing power'.”

As a “constitution,” the Employment Act correspondingly leaves wide latitude for different Administrations and different Economic Advisers to emphasize various elements in the group of objectives set out in the Act. It also provides the flexibility for developing new approaches to meet new situations.

The Economic Reports of the President and the Council of Economic Advisers contain the most detailed statement of Administration fiscal policies. The policy recommendations in the Economic Report of the President may be implemented through all of the major operations and programs of the Federal government. The central focus of fiscal policy, however, is on over-all policies relating to taxes, expenditures, and debt. The recommended policies of the Administration are stated in the President’s Budget Message — very briefly on the tax side, but in detail on the expenditure side. The details of tax proposals are usually submitted in one or more special messages to Congress. The Budget indicates the expected size of the change in the debt and the major components of the change, but the details of Federal debt management have long since been delegated to the Treasury department, and Congress usually considers them only when an increase is requested in the debt limit.

The implementation of fiscal policy means essentially that, in determining the levels of, or the changes to be made in, taxes, expenditures, and debt, account be taken of the prospective effects of these changes on the level of employment, production, and prices. This demands that some assessment be made of the current and prospective nature of the economic situation, and that Federal taxes and expenditures be adjusted so that their effects will tend to promote "maximum employment, production, and purchasing power." These economic objectives and effects, in turn, must be combined in some way with, and given a weighting, as compared with other objectives. As the Act puts it, fiscal policy must be implemented in a manner “consistent with . . . other essential considerations of national policy.”

There is, of course, a wide spectrum of views concerning the size and nature of economic effects and the relative importance to be attached to these effects when tax and expenditure policies must take account of non-economic considerations, such as changes in defense needs.

**The Instruments of Policy**

The instruments of policy may be usefully classified in several ways. One important distinction is between “discretionary” and “automatic” measures. Discretionary tools are those where some

---

active decision must be made to effect a change — to raise taxes, to reduce expenditures, to sell short-term rather than long-term debt, to supply more reserves to the banking system, to raise the Federal Reserve's discount rate. Automatic instruments, also referred to as "built-in" elements, are those characteristics of taxes and government expenditure programs that tend to provide a stimulus to the economy when economic activity begins to fall and to provide restraint when economic activity expands. The progressive individual income tax, with fixed dollar amounts for personal exemptions, is perhaps the prime example.

Automatic or built-in controls have an advantage in the elimination of the lags that occur in the usual decision-making processes of government. Most of the present built-in controls are the result of historical accident — for example, our heavy dependence on the corporation income tax and the progressive personal income tax, the revenue from which fluctuates relatively more than the general level of economic activity. These automatic stabilizers have in fact been more important quantitatively in most post-World War II business cycles than discretionary measures.5

The economy itself, of course, has its own stabilizing tendencies, and it would be desirable to increase the effectiveness of such tendencies, as well as to avoid governmental actions that would reduce the automatic stabilizing elements in the private economy. Among these elements is the tendency for most prices to fall during recessions and rise during expansions. One group of prices — interest rates, the price paid for borrowed funds — has traditionally been presumed to be an effective stabilizer. Interest rates fall sharply during recessions, making it cheaper to borrow and invest, and rise during expansions, making it more expensive to spend beyond one's immediate resources.

The discretionary instruments of fiscal policy include the changes that might be made in expenditure programs to offset deflationary or inflationary pressures (e.g., public works spending in a recession, cut-backs or "slow-downs" in expenditures in boom periods), and the assorted changes that could be made in particular tax rates or in special tax provisions, such as the investment tax credit. Many would include also the timing and choice of different types of government securities that might be issued in periods of recession or boom. Certainly, in recent years the issuance of Treasury bills has been one of the important discretionary measures used to influence short-term interest rates. This "instrument" (among others) has been used to raise short-term interest rates, check short-term outflows of capital, and so help reduce the deficit in the balance of payments.

It would go beyond the scope of this handbook to attempt to list all of the instruments of monetary policy and all of the measures that have been used to meet the balance of payments deficit, to stimulate economic growth or to promote other policy goals.

However, an increasing tendency is notable in the growing use of selective, or voluntary measures (under present conditions) to curb capital outlays, to restrict foreign investment, to limit price and wage increases, to bring political pressures to bear on particular industries and businesses. Such devices are not new — the term "moral suasion," for example, has a long history in the literature on central banking, and governments have

had little reluctance to talk softly or loudly and carry big sticks.

An important issue remains in the choice at any given time between general measures to influence the aggregates of the economy and selective measures that are directed at particular industries, or markets. The latter are likely to interfere with the economy's own stabilizing characteristics as well as its functions in allocating resources. General measures, on the other hand, leave the price system to operate in its normal fashion in particular markets.

Among the pressures that lead to use of specific or selective measures is the fact that it is difficult to gauge the impact a general tax increase or decrease; as a result, the danger of over-doing the corrective action may be significant. Secondly, a general fiscal policy measure often leads to unpalatable political reactions—in the case of both monetary and fiscal policy. Consequently, it is easier to rely first on exhortation, and then on assorted selective measures, before taking the more drastic step, in a period of expansion, of general restrictive measures that may "knock the boom on the head." Enactment of general measures may also involve extensive delays in the legislative process.

Another reason given for the use of selective measures, most recently typified by the wage-price guideposts, is that in important parts of the economy there are elements of monopoly power on the part of both business and labor. As a result, it is argued, costs may be pushed up and the general price level rise, even in the absence of excessive aggregate demand. The "cost-push" type of inflation was said to have been characteristic of the 1955-57 expansion. How important such sources of inflation are is a serious and difficult economic issue. Policies recommended for such situations include the use of wage-price guideposts, intensified anti-trust action, and measures to permit greater foreign competition.6

**ROLE OF FISCAL POLICY SINCE WORLD WAR II**

Evaluating fiscal policy is a difficult task. What the authorities say they do and what they actually do are sometimes different things. The reasons officially offered for certain actions may not be exactly the real or most important reasons. Moreover, given certain policy actions, it requires sophisticated economic and statistical analysis to arrive at conclusions on how these actions have affected the economy and what might have happened under alternative policies.

Only a sketch of recent policies and actions will be attempted here. The purpose is to describe the major changes in policy emphasis and to provide a rough evaluation of results.

**Recent Episodes in Fiscal Policy**

A review of the annual reports of the Council of Economic Advisers shows substantial changes in emphasis on different objectives of policy and different "tools" for pursuing these objectives. The twenty years of experience under the Act also provide plentiful materials

---


A considerable literature is available that examines and evaluates the role of fiscal policy since World War II. A Tax Foundation Research Bibliography is available listing selected references.
### Table 1
Comparison of Original Federal Budget Estimates with Actual Receipts, Expenditures, and Surplus or Deficit

**Fiscal Years 1947-1966**

(Amounts in Millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimate Receipts</th>
<th>Actual Receipts</th>
<th>Estimate less actual</th>
<th>Percent of Actual</th>
<th>Estimate Expenditures</th>
<th>Actual Expenditures</th>
<th>Estimate less actual</th>
<th>Percent of Actual</th>
<th>Surplus (-) or Deficit (-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>$29,462</td>
<td>$39,786</td>
<td>$-10,324</td>
<td>-25.9</td>
<td>$33,074</td>
<td>$39,032</td>
<td>$-5,958</td>
<td>-15.3</td>
<td>$-3,612</td>
</tr>
<tr>
<td>1948</td>
<td>36,894</td>
<td>41,375</td>
<td>$-4,481</td>
<td>-10.8</td>
<td>36,692</td>
<td>32,955</td>
<td>$+3,737</td>
<td>+11.3</td>
<td>+4,808</td>
</tr>
<tr>
<td>1949</td>
<td>43,894</td>
<td>37,663</td>
<td>$+6,231</td>
<td>+16.5</td>
<td>39,086</td>
<td>39,474</td>
<td>$-388</td>
<td>-1.0</td>
<td>-873</td>
</tr>
<tr>
<td>1950</td>
<td>40,362</td>
<td>36,422</td>
<td>$+3,940</td>
<td>+10.8</td>
<td>41,235</td>
<td>39,544</td>
<td>$+1,691</td>
<td>+4.3</td>
<td>-5,133</td>
</tr>
<tr>
<td>1951</td>
<td>36,643</td>
<td>47,480</td>
<td>$-10,837</td>
<td>-22.8</td>
<td>41,776</td>
<td>43,970</td>
<td>$-2,194</td>
<td>-5.0</td>
<td>-16,456</td>
</tr>
<tr>
<td>1952</td>
<td>54,299</td>
<td>61,287</td>
<td>$-6,988</td>
<td>-11.4</td>
<td>70,755</td>
<td>65,303</td>
<td>$+5,452</td>
<td>+8.3</td>
<td>+14,386</td>
</tr>
<tr>
<td>1953</td>
<td>69,987</td>
<td>64,671</td>
<td>$+5,316</td>
<td>+8.2</td>
<td>84,373</td>
<td>74,120</td>
<td>$+10,253</td>
<td>+13.8</td>
<td>-14,456</td>
</tr>
<tr>
<td>1954</td>
<td>68,430</td>
<td>64,420</td>
<td>$+4,010</td>
<td>+6.2</td>
<td>77,749</td>
<td>67,537</td>
<td>$+10,212</td>
<td>+15.1</td>
<td>-9,922</td>
</tr>
<tr>
<td>1955</td>
<td>62,061</td>
<td>60,209</td>
<td>$+1,852</td>
<td>+3.1</td>
<td>65,389</td>
<td>64,389</td>
<td>$+1,000</td>
<td>+1.6</td>
<td>-2,928</td>
</tr>
<tr>
<td>1956</td>
<td>59,685</td>
<td>67,850</td>
<td>$-8,165</td>
<td>-12.0</td>
<td>62,093</td>
<td>66,224</td>
<td>$-4,131</td>
<td>-6.2</td>
<td>-2,408</td>
</tr>
<tr>
<td>1957</td>
<td>65,833</td>
<td>70,562</td>
<td>$-4,729</td>
<td>-6.7</td>
<td>65,398</td>
<td>68,966</td>
<td>$-3,568</td>
<td>-5.2</td>
<td>+435</td>
</tr>
<tr>
<td>1958</td>
<td>73,053</td>
<td>68,550</td>
<td>$+4,503</td>
<td>+6.6</td>
<td>71,240</td>
<td>71,369</td>
<td>$-129</td>
<td>-0.2</td>
<td>+1,813</td>
</tr>
<tr>
<td>1959</td>
<td>74,045</td>
<td>67,915</td>
<td>$+6,130</td>
<td>+9.0</td>
<td>73,579</td>
<td>80,342</td>
<td>$-6,763</td>
<td>-8.4</td>
<td>+466</td>
</tr>
<tr>
<td>1960</td>
<td>76,406</td>
<td>77,763</td>
<td>$-1,357</td>
<td>-1.7</td>
<td>76,336</td>
<td>76,539</td>
<td>$-203</td>
<td>-0.3</td>
<td>+70</td>
</tr>
<tr>
<td>1961</td>
<td>83,346</td>
<td>77,659</td>
<td>$+5,687</td>
<td>+7.3</td>
<td>79,162</td>
<td>81,515</td>
<td>$-2,353</td>
<td>-2.9</td>
<td>+4,184</td>
</tr>
<tr>
<td>1962</td>
<td>82,333</td>
<td>81,409</td>
<td>$+924</td>
<td>+1.1</td>
<td>80,865</td>
<td>87,787</td>
<td>$-6,922</td>
<td>-7.9</td>
<td>+1,468</td>
</tr>
<tr>
<td>1963</td>
<td>93,000</td>
<td>86,376</td>
<td>$+6,624</td>
<td>+7.2</td>
<td>92,537</td>
<td>82,642</td>
<td>$+105</td>
<td>+1.1</td>
<td>+463</td>
</tr>
<tr>
<td>1964</td>
<td>86,990</td>
<td>89,459</td>
<td>$+2,559</td>
<td>+2.9</td>
<td>98,902</td>
<td>97,684</td>
<td>$+1,218</td>
<td>+1.1</td>
<td>+11,902</td>
</tr>
<tr>
<td>1965</td>
<td>93,000</td>
<td>93,044</td>
<td>$-44</td>
<td>(c)</td>
<td>97,900</td>
<td>96,518</td>
<td>$+1,382</td>
<td>+1.5</td>
<td>-4,900</td>
</tr>
</tbody>
</table>

Average of percentage differences between estimates and actuals:

| 1947-1966 | 9.0 |
| 1955-1966 | 5.7 |

*Average of percentage differences between estimates and actuals:* 9.0, 5.7

**Notes:**

a. Actual receipt and expenditure figures are from the historical comparison of budget receipts and expenditures in the 1967 Federal Budget. To correspond with the historical series, the following items have been deducted from the original budget receipts and expenditure estimates and actual figures: (1) Railroad Retirement Account, 1947-1954, (2) refunds of receipts and capital transfers, 1947, and (3) interfund transactions, 1948-1961 inclusive.

b. Simple arithmetic averages computed without regard to sign.

c. Less than .05 percent.

Source: Bureau of the Budget.
Chart 1
FEDERAL CASH PAYMENTS TO AND RECEIPTS FROM THE PUBLIC, CASH BUDGET SURPLUS OR DEFICIT, SURPLUS OR DEFICIT IN THE NATIONAL INCOME ACCOUNTS, AND DEFENSE DEPARTMENT OBLIGATIONS
Quarterly 1948-1966

Note: Scales "L" are logarithmic; scales "A" are arithmetic.
Shaded areas are periods of recession. "P" = peak. "T" = trough.

both for those who are inclined to criticize the activities of the Council and for those who are inclined to applaud its activities. Any reasonably objective observer can find much that can be called success as well as much that can be called mistakes, misjudgments, or weaknesses.

In the early post-World War II years the emphasis of fiscal policy was on checking inflation. In the fiscal years 1946 and 1947 the administrative and cash budgets showed substantial surpluses, although the surpluses were much larger than expected in the budgets for these years. The brief recession of 1949 was met by relatively few new measures, in part because the first large postwar tax reduction in 1948 happened to coincide with the recession. Moreover, an easy money policy and low interest rates probably contributed to the early recovery.

In the Korean War (which broke out in June 1950), tax increases under the Revenue Acts of 1950 and 1951 exceeded the initial increase in defense expenditures. As a result, a sizable surplus was achieved in the fiscal year 1951. However, expenditures then rose faster than revenues with the result that by fiscal 1953 the budget was in deficit (see Chart 1 and Table 1).

In this period monetary policy was brought to bear as a result of the 1951 "Accord" between the Treasury and the Federal Reserve System. The Treasury gave up its insistence that interest rates on government securities be maintained at artificially low levels. With the removal of this restriction the Federal Reserve was able to exercise its function of checking the expansion of money and credit when inflationary pressures were present. The result is evident in the rise in interest rates during the Korean War (Chart 2).

"Tight" fiscal and monetary policies during the Korean War were combined with specific controls over certain prices, wage rates, and supplies. While prices did initially rise rapidly, the total rise was small by previous wartime standards, and it was checked early.

During the recession of 1954, fiscal policy was expansionary in that taxes were reduced, and revenues declined; while defense expenditures dropped, nondefense expenditures increased. The budget deficit was $3.1 billion in fiscal 1954 and $4.2 billion in fiscal 1955. The tax reduction was again an appropriate fiscal policy action more by accident than design, because the Korean War Revenue Acts had 1954 expiration dates initially written into them for most of the tax increases. The Internal Revenue Code of 1954 made numerous structural changes in the tax system including the introduction of new methods of depreciation, which provided a stimulus for business investment.

The first post-World War II decade saw relatively little that was new in discretionary fiscal and monetary policies. The policies developed during World War II were carried over to meet the two major expansions and the inflationary pressures that accompanied them. The two recessions of 1949 and 1954 were met in part by deficits reflecting tax reductions that would have come about in any case, and in part by the automatic stabilizing effects of a revenue system that during World War II had greatly increased its dependence on income taxes.

In examining the changes that have come about in the more recent business cycles, it will be useful to examine: (1)
Chart 2
SELECTED SHORT AND LONG TERM INTEREST RATES
Monthly 1948-1966

Note: Scales "L" are logarithmic; scales "A" are arithmetic.
Shaded areas are periods of recession. "P" = peak. "T" = trough.

policy statements in the President's Budget Message and Economic Report and in the reports of the Council of Economic Advisers and the Joint Economic Committee; (2) the major actions taken to meet recession or excessive expansion; and (3) the apparent results of these actions.

The over-all results of Executive and Congressional action on taxes and expenditures are reflected in the "cash budget" and in Federal receipts and expenditures as shown in the national income accounts. Both of these statements of Federal accounts are more relevant for purposes of fiscal policy than the administrative budget because they include trust funds as well as general fund operations, and give a more complete picture of Federal operations.\(^8\)

In the last three or four years the tendency has been to use the national income accounts budget as the best general basis for purposes of counter-cyclical policy. Previously, the cash budget was more commonly used. However, it is generally recognized that no single set of accounts is fully adequate for showing effects on economic activity. Existing forms of Federal accounts have various deficiencies, and changes and improvements continue to be made from year to year.\(^9\)

**The Expansion of 1955-57.** During this expansion, fiscal policy consisted essentially of "holding the line" on taxes, that is, postponing scheduled reductions in certain Korean War rate increases (excises and the corporation income tax), endeavoring to limit the increase in ex-

---

8. These are the major annual official documentary sources of fiscal policy statements. Current sources of official policy statements are speeches made by the Chairman of the CEA, the Secretary of the Treasury, and other officials, and the testimony of these officials before committees of the House and Senate.


10. For a discussion of the limitations of various forms of accounts for fiscal policy purposes, see Joseph Sherer, "On Measuring Fiscal Policy," Journal of Finance, Vol. 20, No. 4, December 1965, pp. 683-690. (See also p. 22 below for a brief discussion of the "full employment budget.")

---

### Table 2

<table>
<thead>
<tr>
<th>Fiscal Years 1956-1958 (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Administrative Budget(a)</strong></td>
</tr>
<tr>
<td><strong>Cash Budget(b)</strong></td>
</tr>
<tr>
<td>Year</td>
</tr>
<tr>
<td>1956</td>
</tr>
<tr>
<td>1957</td>
</tr>
<tr>
<td>1958</td>
</tr>
</tbody>
</table>

a. Excludes trust funds.
b. Consolidated cash receipts from and payments to the public.

Source: Bureau of the Budget.