FISCAL POLICY DURING THE KENNEDY ADMINISTRATION (1961-1963)

by

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CHAPTER I

INTRODUCTION

The topic "Fiscal Policy During the Kennedy Administration (1961-1963)" has been chosen for various reasons. An active fiscal policy was practiced, and methods used during that period have been repeatedly used by Kennedy's successors. So a study of that period helps to understand the various measures undertaken by the government in the following years.

The report is divided into four main parts. The first chapter, Introduction, gives a survey of the report, and explains what is meant by fiscal policy. The second chapter, The Fight Against Recession, deals exclusively with the fiscal policy from 1961 to 1963. The first two parts of that chapter show the problems which the Kennedy Administration had to face and the first measures they took in order to solve them. It gives an insight into the variety of actions which were undertaken in 1961. In the following two parts deficit spending and measures to provide a stimulus for investment are discussed thoroughly. Single measures were not regarded any longer but the question was asked, "How much, all measures taken together, from 1961 to 1963, the economic situation of that time was influenced?" A summary at the end of the second chapter summarizes the economic developments of that period.

Chapter III deals with the tax reductions, which were initiated under President Kennedy, but signed and enacted under President Johnson. Although the tax reductions did not take place during the Kennedy Administration, it has been regarded widely as a fiscal policy of his administration. In showing how effective the tax-cut policy was, the years of 1964 and 1965 had to be discussed.

In chapter IV a short summary of developments in the U.S. economy during this period is given. As economic measures undertaken by the government do not very often have an immediate effect on the economy, it seemed to be reasonable to go beyond the year of 1963 and summarize economic developments until 1965. Some critics concerning the fiscal policy of the Kennedy Administration are presented in this last chapter.

"The basic task of Federal fiscal policy is to help to provide a total market demand for goods and services that neither exceeds nor falls short of the economy's productive capacity at full employment."[1/]

While in this above quotation Slesinger stressed the necessity that the economy should operate at its full productive capacity, which can be regarded as a final goal of fiscal policy, one usually thinks of the three objectives, which are price level stability, full employment, and equilibrium in the balance of international payments. To these three objectives is usually added a fourth one, the aim of stimulating economic growth, which is regarded more and more as an essential objective of fiscal policy. In order to achieve the above mentioned goals one must consider the following basic requirements:

1. The productive capacity of a country grows steadily over time. This implies that demand must grow too. If demand does not grow as much as the

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[1/] Reuben E. Slesinger, National Economy Policy: The Presidential Reports (Princeton, New Jersey: D. van Nostrand Comp., Inc., 1968), p. 172.

capacity of a country, then there will be an excess of supply, which causes private industry to produce less in the next period. This means less demand, less income, etc., which might bring about depression.

2. Fluctuations in private demand occur independently of Federal policy. These fluctuations can lead to dips or surges and their further development could bring about recession or inflation. Therefore, these fluctuations must be offset in order to avoid the above mentioned possibilities.

The question arises now, "What are the instruments of fiscal policy?" The major tools for expanding or restraining over-all demand are:

1. Government purchases of goods and services
2. Transfer payments
3. Grants-in-aid
4. Subsidies
5. Taxes

Federal purchases of goods and services are directly part of market demand, and through their impact on production, employment, and income, they encourage further private consumption and investment expenditures. Taxes, transfers, subsidies, and grants-in-aid affect consumption and investment through their influence on disposable personal income, after-tax profits, incentives, and State and local expenditures.

Fiscal policy can be very weak if not sustained by coordinated monetary measures. Furthermore, one should not forget that we are dealing with the administration, a political institution , which might have the right answers, but not sufficient political power to transform these answers into actions.

The task of this report is to outline the fiscal measures taken from 1961 to 1963. Their effect upon the American economy is discussed in the following chapters. No attempt is made to judge the appropriateness of these measures. Furthermore, sources like Heller[2], Canterbery[3], Sorensen[4], as well as the Presidential Reports, have been used mainly, which means that fiscal policies undertaken under Kennedy's Administration have been regarded as a "positive" contribution toward the goals of full employment and economic growth. Opinions, like Friedman's[5], that the achievements of the Kennedy Administration are due more to the monetary policies of the Federal Reserve Board are only mentioned, but not considered in any great detail. Therefore, the reader should be aware, that it is not a fully objective report because of the above mentioned reasons.

Furthermore, the distinction between the impacts of monetary and fiscal policy during any period is extremely difficult, or nearly impossible. The view which any writer takes concerning that period (from 1961 to 1963) is based partly on value judgements.

Although the title suggests that only the period from 1961 to 1963 has been considered, it is obvious that a report about that period cannot exactly start at January, 1st, 1961 and end at December, 31st, 1963.

2/ Walter W. Heller, New Dimensions of Political Economy (New York: W. W. Norton & Comp., Inc., 1967)

3/ Ray. E. Canterbery, Economics on A New Frontier (Belmont, California: Wadsworth Publishing Comp., Inc., 1968)

4/ Theodore C. Sorensen, Kennedy (New York: Harper & Row, Publishers, 1965)

5/ Milton Friedman and Walter W. Heller, Monetary vs. Fiscal Policy - A Dialogue (New York: W. W. Norton & Comp., Inc., 1969)

CHAPTER II

THE FIGHT AGAINST RECESSION

The Problems Kennedy Had to Face

When John F. Kennedy took office as President, he had to deal with a recession which had started in May, 1960. In January, 1961, nearly 8% of the labor force was unemployed and a production gap[6] of $ 50 billion existed. The gap between actual and potential output reflected not only the recession of 1960-1961, but also the incomplete recovery from the recession of 1957-1958. So it was President Kennedy's task to find a way, which would finally lead to the recovery of the economy.

In his first State of the Union address (Jan., 1961) President Kennedy gave the following description of the economy:

> The present state of our economy is disturbing. We take office in the wake of seven months of recession, three and one-half years of slack, seven years of diminished economic growth, and nine years of falling farm income ....
>
> Save for a brief period in 1958, insured unemployment is at the highest peak in our history. Of some five and one-half million Americans

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[6] Production gap is the difference between actual and potential output. Potential output is the dollar value of GNP (gross national product), or national income, if all resources in the nation (workers, natural resources, plants, and managers) are fully and efficiently employed. Actual GNP, or national income, is realized output and is the dollar volume of output forthcoming from a given level of money demand for goods and services.

who are without jobs, more than one million have been searching for work for more than four months ....

In short, the American economy is in trouble. The most resourceful industrialized country on earth ranks among the last in the rate of economic growth. Since last spring our economic growth rate has actually receded. Business investment is in a decline. Profits have fallen below predicted levels. Construction is off. A million unsold automobiles are in inventory. Fewer people are working, and the average work week has shrunk well below forty hours ....

This Administration does not intend to stand helplessly by ... to waste idle hours and empty plants while awaiting the end of the recession ....

I will propose to the Congress within the next fourteen days measures ... aimed at insuring a prompt recovery and paving the way for increased long-range growth.[7]

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[7] Sorensen, Kennedy, p. 396

First Measures in 1961

In February, 1961 President Kennedy recommended the following seven measures to Congress:

1. to add a temporary thirteen-week supplement to unemployment benefits
2. extend aid to children of unemployed workers
3. increase Social Security payments
4. to redevelop distressed areas
5. to raise minimum wage
6. to provide emergency relief to feed grain farmers
7. to finance a comprehensive home-building and slum clearance program.

All seven measures were accepted and became law by the end of June, 1961. Nearly \$ 800 million in extended jobless benefits for nearly three million unemployed, over \$ 200 million in additional welfare payments to 75,000 children and their parents, more than \$ 400 million in aid to over 1,000 distressed areas, \$ 175 million in higher wages and an estimated 420,000 construction jobs under the new Housing Act were the result of the above mentioned measures.[8/]

Furthermore, all agencies were directed by executive order to hasten their procurement and construction programs. Beginning in March an 18-month post office construction program was compressed by the administration.

[8/] Sorensen, Kennedy, p. 397

The supports for farm prices were raised on corn, cotton, butterfat and milk, and soybeans. Coupled with these measures was a speeding up of payments for storage of crops. In early March these payments amounted to about $ 25 million. The distribution of both tax refunds and GI life insurance dividends payable during the year ($ 258 million) were made available in the first quarter, and a special dividend of about an equal amount was made at midyear. Together with an advanced release of highway funds ($ 718 million), these actions were designed to pump more money into the economy.[9]

One of the major programs was the Area Redevelopment Act of 1961, signed May, 1961. It provided a wide range of Federal assistance to areas with substantial and persistent unemployment and underemployment. Measures undertaken under the Area Redevelopment Act can be summarized in the following way:

1. Long-term, low interest loans to commercial and industrial enterprises
2. Loans and grants for community facilities
3. Liberalization of urban renewal facilities
4. Technical assistance to help hard-hit areas to plan economic expansion
5. Job training programs

By the end of 1962 a Federal investment of $ 71 million had been approved by ARA to help to create more than 26,500 direct jobs in new or expanding industries.

In renewing the fiscal measures taken by the government in 1961, we find that the tools of fiscal policy were used in the following way:

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[9] U.S., President, Economic Report of the President together with The Annual Report of the Council of Economic Advisers (Washington: United States Government Printing Office), Jan., 1962, p. 97-98

1. Government purchases of goods and services: advanced release of highway funds, speedup in procurement and construction
2. Government transfer payments: temporary extension of unemployment benefits and aid to states for children of unemployed, increase in Social Security benefits, accelerated Veteran's insurance dividend payments
3. Government grants: Loans and grants under the Area Redevelopment Act
4. Tax rate change: none.

Unemployment, which had been close to 8% of the labor force ever since December, 1960, fell sharply toward the end of 1961, reaching 6.1% in December, 1961.

GNP grew from \$ 501 billion (annual rate) in the first quarter to \$ 542 billion in the last quarter. This increase of \$ 41 billion (current prices, annual rate) in GNP, from the first quarter to the last quarter of 1961, distributed substantial gains in income. Personal income grew by \$ 24 billion. Wage and salary disbursements, which had expanded by \$ 19 billion accounted for most of the increase in personal income.[10/] The growth of GNP narrowed the over-all gap of unused potential from an estimated 10% to 5%.

Federal expenditures increased by \$ 9.1 billion (calendar year) from 1960 to 1961. A detailed summary of the expenditures in 1960 and 1961 is given in table I.

[10/] U.S., President, <u>Economic Report</u>, Jan., 1962, p. 57

TABLE I

FEDERAL EXPENDITURES IN 1960 AND 1961
(Billions of dollars)[11]

	1960	1961	Changes
Purchases of Goods and Services	$ 53.5	$ 57.4	$ + 3.9
Transfer Payments to Persons and Foreigners	23.4	27.1	+ 3.7
Grants-in-Aid to States and Local Governments	6.5	7.2	+ 0.7
Subsidies	2.5	3.8	+ 1.3
Net Interest Paid	7.1	6.6	less 0.5
Total	$ 93.0	$ 102.1	$ + 9.1

[11]Canterbery, Economics on A New Frontier, p. 108

During 1961, the estimated full-employment surplus[12/] declined significantly from an annual rate of $ 12½ billion in the second half of 1960 to $ 8½ billion in the second half of 1961. Since private income 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 1961.[13/]

The gains of 1961[14/] can be summarized in the following way:

1. Industrial production showed a total rise of 13%.
2. Nearly half of the plant capacity, which was idle at the beginning of that year, was brought back into productive use.
3. Unemployment had dropped from 6.8% to 6.1% of the labor force. The number of areas with substantial labor surplus declined from 101 in March to 60 in December.
4. Price stability had been maintained during the recovery, and the confidence in the dollar was restored.

"The speed of the recovery, if not the recovery itself, can be largely attributed to a combination of the Kennedy Administration's anti-recession measures plus the unexpected jump in defense expenditures."[15/]

12/ Full-employment surplus. A measure of the surplus which could occur in the federal government budget, if the economy were at full (or high) employment. This concept is used because the actual amount of tax collections (and certain expenditures like employment compensation) is dependent upon the level of economic activity, once the government has set the tax and expenditures rates.

13/ U.S., President, Economic Report, Jan., 1962, p. 83

14/ Ibid., p. 5

15/ Canterbery, Economics on A New Frontier, p. 109

But as 1961 ended, actual output was still $ 25 to $ 30 billion short of potential and unemployment was far too high. Despite the near $ 4 billion deficit, there was still a full-employment surplus over $ 10 billion.

Table II summarizes the economic developments in 1961 mentioned in this chapter. The facts, expressed in figures, give an idea about the impact of fiscal and monetary policy upon the economic developments of 1961. It is obvious that the fiscal measures had an important impact but how important this impact was cannot be measured exactly.

TABLE II

SUMMARY OF ECONOMIC DEVELOPMENTS FROM THE FIRST QUARTER OF 1961 TO THE FOURTH QUARTER OF 1961[16/]

	1961: I	1961: IV
GNP (Billions of dollars)	$ 500.8	$ 542.0
Federal Expenditures (NIA basis) (Billions of dollars)	$ 98.0	$ 104.3
Full-employment surplus - an estimate (Billions of dollars)	$ 12.5	$ 10.0
Production gap - an estimate (Billions of dollars)	$ 50.0	$ 30.0
Unemployment		
a) in millions	4.7 (Jan.)	4.3 (Dec.)
b) in per cent of the labor force	% 6.6 (Jan.)	% 6.1 (Dec.)

16/U.S., President, Economic Report, Jan., 1962, p. 207, p. 231, p. 276

Deficit Spending as A Major Weapon to Fight Recession

This part of chapter II discusses the role of Federal expenditures from 1961 to 1963. In the remaining parts of this chapter the measures undertaken during the whole period from 1961 to 1963 are discussed while the preceding discussion was limited to 1961.

The volume of tax revenues rises as incomes grow if tax rates remain unchanged. In order not to have a growing full-employment surplus with increasingly restrictive effects on the economy, tax rates must be reduced or expenditures have to grow at the same rate as revenues rise.

The budget is a flexible tool, which may be operated in an expansionary or retarding direction. Insufficient demand means unemployment, idle capacity, and lost production. Excessive demand means inflation, general price increases, bringing both little or no gains in output and real income, assuming that the economy is at full employment.

Under President John F. Kennedy, expansion of expenditures was not regarded as the most important tool to achieve growth and full employment. During his administration, the reduction of taxes was more strongly stressed. Expenditures are discussed first and the tax measures later.

From the first quarter of 1961 to the fourth quarter of 1963, Federal purchases of goods and services increased by \$ 11½ billion (annual rates, current prices), or 21%. Total Federal expenditures, which include transfer payments, subsidies, interest, and grants-in-aid as well as purchases of goods and services, increased by \$ 19½ billion (current prices), or 20%, over the same period.[17]

Federal purchases, after allowance for price changes, rose by 16% from the first quarter of 1961 to the fourth quarter of 1963, and accounted for 11% of the total increase in demand.[18]

Federal expenditures increased by $ 17 billion, after allowance for price changes, or roughly 17%, from the first quarter of 1961 to the fourth quarter of 1963. These expenditures were primarily undertaken to strengthen defense and space programs. National Defense expenditures were mainly imposed upon the government by "exogenous" conditions, like the Berlin crisis. Federal expenditures raised the level of aggregate demand and so were highly stimulating for the economy. In a fully employed economy these increases would have required new tax revenues. The President did not recommend such tax measures because they would have cut into purchasing power and retarded recovery.

Jacoby[19] distinguishes between two types of Federal expenditures:

1. investment-type expenditures

2. consumption-type expenditures

Investment-type expenditures - outlays for additions to physical assets, investment in human capital, outlays on research and development, health, and education - are growth promoting upon the private sector. Consumption-type expenditures - outlays for aids, subsidies, and services to particular groups- are not growth-promoting although they elevate the standard of living.

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[17] U.S., President, Economic Report, Jan., 1964, p. 46

[18] Ibid., p. 32

[19] Neil H. Jacoby, "The Fiscal Policy of the Kennedy-Johnson Administration", Journal of Finance, XIX (May, 1964), pp. 353-69

Jacoby argues that the stimulus of economic growth from Federal expenditures is determined by the proportion of investment-type outlays to total Federal expenditures. In table III the changes in the proportions of investment-type expenditures to the total Federal expenditures are represented. The proportion of investment-type outlays to total Federal expenditures increased, while the proportion of consumption-type expenditures slightly decreased. This means that the policies of the Kennedy Administration were mildly growth-promoting which can be seen in the increase of investment-type expenditures.

Investment-type expenditures increased from \$ 25.9 billion (38.2%) in fiscal year 1954 to \$ 40.8 billion (40.9%), proposed by President Kennedy for the fiscal year 1964.

In this table both outlays, civil outlays as well as outlays for National Defense, have been regarded together. The distinction between investment-type and consumption-type expenditures for National Defense is not very clear.

> So-called "investments" in missiles, planes, warships and military research and development probably add little more per dollar to the long-run growth of the U.S. economy than do operating outlays on military personnel and maintenance, if, indeed, they make any positive contribution at all.[20]

During the Kennedy Administration investment-type outlays increased modestly, even if the expenditures for National Defense and Space Programs are not considered. Civil investment spending has been growing at an annual rate of 12 %, consumption spending at about 6%. Major investment-type civil expenditure programs were initiated under President Eisenhower and included the National Federal-Aid Highway program, the National Aviation and Space

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[20] Jacoby, "Fiscal Policy", P. 360

Agency, and the National Defense Education programs. The Kennedy Administration continued and expanded these programs and also enacted the Area Redevelopment Act of 1961, the Public Works Acceleration Act of 1963, the Manpower Development and Redevelopment Act of 1962, and the Senior Citizens Housing Act of 1962.

The annual rise of output during 1961-1963 has much exceeded the average of the preceding decade. The rate of national economic growth was less than 3%, while the three-year average (from 1961 to 1963) was nearly double that level.

The fiscal programs adopted during this period lowered the \$ 12 billion full-employment surplus of 1960 to \$ 6½ billion by 1962. This was accomplished by tax reductions and expenditure increases.

TABLE III

NET FEDERAL EXPENDITURES UNDER ADMINISTRATIVE BUDGETS: 1954, 1962, AND 1964
(Billions of dollars) 21/

	1954 Amount	1954 %	1962 Amount	1962 %	1964 (proposed) Amount	1964 (proposed) %
I. Investment-type expenditures						
1. Additions to assets						
Civil	$ 2.8	4.1	$ 5.6	6.4	$ 6.3	6.3
Nat. Defense	19.9	29.4	17.3	19.6	18.9	19.0
	22.7	33.5	22.9	26.0	25.2	25.3
2. Development						
Civil	1.6	2.4	3.2	3.6	6.8	6.8
Nat. Defense	1.6	2.4	7.8	8.8	8.8	8.8
Sub-total	25.9	38.2	33.9	38.4	40.8	40.9
II. Consumption-type expenditures						
1. Aids and special services						
Civil	8.5	12.5	16.2	18.3	17.0	17.1
Nat. Defense	3.7	5.5	1.4	1.6	1.4	1.4
	12.2	18.0	17.6	19.9	18.4	18.5
2. General						
Civil	8.5	12.5	12.3	13.9	13.6	13.7
Nat. Defense	21.3	31.4	24.6	27.8	26.7	26.8
Sub-total	42.0	61.9	54.5	61.6	58.7	59.0
Total	$ 67.8	100	$ 88.4	100	$ 99.5	100

21/ Jacoby, "Fiscal Policy", p. 359

Tax Measures to Provide a Stimulus for Investment

The past three years (from 1957 to 1960) of unemployment and excess capacity led to inadequate business investment. In 1962 the rate of investment was almost unchanged from 1957 though GNP had almost risen by 16%, after allowance of price changes. GNP (in 1962 prices) grew from $ 478.5 billion in 1957 to $ 553.6 billion in 1962. In the same period, gross private domestic investment (in 1962 prices) grew from $ 70.2 billion to $ 76.2 billion.[22/] The weakness of demand for investment was both cause and effect of the weakness of total demand.

The Kennedy Administration recognized from the start that it could not hope to achieve its objectives of faster growth, stable prices, and a shrinking balance of payments deficit without stepping up investment in plant and equipment. To modernize, mechanize, and automate, to translate advanced technology into actual output was essential in achieving faster growth. There was only one answer, which was to offer special incentives for investment in machinery and equipment. In April, 1961 $ 3 billion of tax incentives to investment in plant and equipment were recommended by the government and put into effect in 1962. There were two tax measures adopted to provide the needed long-run stimulus to lagging investment:

1. new depreciation guidelines

[22/] U.S., President, Economic Report, Jan., 1963, p. 172

2. an investment tax credit

A liberalization of the timetables and guidelines applied by the Internal Revenue Service to the depreciation of machinery and equipment was enacted July, 1962. These new guidelines presented a new and simplified method of computing depreciation. Furthermore, they permitted a more rapid write-off for approximately 70 to 80% of the machinery and equipment used by private business. No change had been made in the depreciation of buildings. For machinery and equipment used in manufacturing, allowable asset lives were 32% shorter, on the average, than they were under the old guidelines. The amount of depreciation, which could be taken in 1962, was estimated to be $ 32 billion, which was $ 4.7 billion, or 17%, more than the amount, which could have been taken by corporate and noncorporate tax-payers under the old guidelines. The revenue loss for the Government was estimated to be $ 1 billion.[23/]

A 7% investment tax credit was enacted by Congress in the Revenue Act of 1962. This credit was granted for investment in depreciable machinery and equipment used in the United States. The amount of the credit was thought to offset, in full, tax liabilities up to $ 25,000 and one-fourth of the tax liabilities above this figure. A 3-year carryback and a 5-year carryforward were provided for unused credits. The computation of the credit applied to the full amount of the cost of the property, with an estimated life of 6 to 8 years, and to one-third of the cost of the property with an estimated life of 4 to 6 years. All investment in eligible new property, and up to $ 75,000 a year of investment in eligible used property, were qualified for the credit.

[23/] U.S., President, Economic Report, Jan., 1963, p. 136

The depreciation basis was reduced by the investment credit allowed.[24]

Both tax measures saved business over $ 2 billion a year in taxes and strengthened incentives to invest by an estimated 20% increase in the profitability of eligible new investment in plant and equipment.[25]

From the fourth quarter of 1961 to the fourth quarter of 1962, total business investment declined from $ 77.4 billion to $ 74.8 billion. Expenditures for new plant and equipment rose by $ 3.1 billion, but its advance was more than offset by a drop of $ 5.5 billion in the rate of inventory investment. The Department of Commerce estimated that the existing stock of business structures and equipment increased by only 2% per year from 1957 to 1962, compared with 4 % a year in the period 1947-1957.[26]

Business was at first suspicious, because these measures had come from a government which was traditionally "anti-business". But the bill was widely used and outlays on plant and equipment in 1963 crossed the $ 40 billion mark for the first time in history. The administration's two tax measures were estimated, by an independent business survey, to have been responsible for nearly half of this expansion.[27]

Through a combination of expenditure increases and tax reductions the full-employment surplus was reduced to $ 6½ billion in 1962.

24/ U.S., President, Economic Report, Jan., 1963, p. 137
25/ Ibid., p. 18
26/ Ibid., p. 15, p. 29, p. 172
27/ Sorensen, Kennedy, p. 401-2

Summary (1961-1963)

In 1960, the full-employment, or potential, surplus had grown to an estimated \$ 13 billion, a level that not only was a factor in the 1960 recession, but threatened to hold unemployment at high levels. Only through a tremendous rise in investment could full employment have been achieved. But starting in 1961, substantial expenditure increases and tax reductions began to remove the fiscal overburden. Defense and space spending rose sharply, and public-sector civilian programs rose more moderately. At the same time, in 1962, the 7% investment credit and liberalized depreciation stimulated capital formation and productivity growth in the private sector.

These measures cut the potential surplus in the national income accounts budget in half, to \$ 6½ billion by 1962. Yet, by mid-1962, the potential surplus was still too large. Major income tax cuts should have been the next big fiscal step, coupled with some further increases in spending. Delays in enacting the tax cut let the potential surplus rise again in 1963.

Table IV gives a summary of the economic developments from 1960 to 1963. The high-employment surplus can be regarded as an indicator of economic growth, because the full-employment surplus is an estimate of the budget outcome for any given budget, assuming that the economy is at full employment. If the full-employment surplus is too large, economic activity is short of potential, which means that economic resources are unemployed or under-employed. Both, the full-employment surplus, as well as the production gap, are estimates. The other rows show the actual figures in GNP, unemployment, and Federal budget receipts and expenditures. Although there has been a tremendous rise in Federal expenditures and an increase in GNP, the unemployment rate was nearly stable since 1960. The gap between potential and actual output narrowed from an estimated $ 50 billion in 1960 to an estimated $ 30 billion in 1961 and stayed at that level the following two years.

TABLE IV

A SUMMARY OF THE ECONOMIC DEVELOPMENTS (1960-1963)[28]

	1960	1961	1962	1963
Production gap (Billions of dollars)	$ 50.0	$ 30.0	$ 30.0	$ 30.0
High-employment surplus (Billions of dollars)	$ 12.5	$ 10.5	$ 6.5	$ 9.0
GNP (Billions of dollars)	$ 502.6	$ 518.2	$ 554.9	$ 585.0
Federal budget receipts and expenditures during the fiscal years (Billions of dollars)				
a) net budget receipts	$ 77.7	$ 77.7	$ 81.4	$ 86.3
b) budget expenditures	$ 76.5	$ 81.5	$ 87.7	$ 92.6
Unemployment				
a) in millions	3.9	4.8	4.0	4.1
b) in per cent of the labor force	% 5.6	% 6.7	% 5.6	% 5.7

[28] U.S., President, Economic Report, Jan., 1964, p. 207, p. 230, p. 274

CHAPTER III

TAX REDUCTION 1963

The Advantages of A Tax Cut

The theory supporting the stimulating effect of the Kennedy Administration's tax reductions is as follows: Tax cuts vitalize free markets and private incentives, they supply added funds for private capital formations, and boost private demand.

Tax reductions will directly increase disposable income and purchasing power of consumers and business, strengthen incentives and expectations, and raise the net returns on new capital investment. This will lead to initial increases in private consumption and investment expenditures. These increases in spending will set off a cumulative expansion, generating further increases in consumption and investment spending, and a general rise in production, income, and employment.

A reduction in corporate tax rates will increase the after-tax profits of corporations as a result of which corporations may be expected to increase their dividend payments.

Tax reduction is a creative instrument for harmonizing public and private interests. Both the taxpayer as consumer and the taxpayer as producer, businessman or farmer, gain from a tax cut. As the economy returns to full employment the budget will tend to return to a balance. A tax cut could not create more employment, growth, etc., if the economy were operating at the limits of its productive capacity and would have inflationary effects.

Furthermore, tax reduction increases productivity and tends to cut unit labor costs by stimulating cost-cutting investment and technological advance, and reducing distortions in resource allocations. The American economy was fully ready to a stimulus of tax reductions since 1961. The needs were:[29]

1. To provide markets to bring back into production underutilized plant and equipment.
2. To provide incentives to invest, in the form of wider markets and larger profits, investment that will expand, modernize, innovate, cut costs.
3. All this would lead to more jobs for the unemployed and for new workers streaming into the labor force.

This could be achieved through a tax cut, as the advantages are:[30]

1. stimulate cost-cutting industries
2. strengthen incentives
3. promote a more efficient allocation of productive resources
4. a balanced tax program serves to lower unit costs.

All these achievements are a basis for continued price stability and an improved American competitive situation in the world markets.

29/ U.S., President, Economic Report, Jan., 1963, p. XV
30/ Slesinger, National Economic Policy, p. 152

The Difficulties the Advocates of a Tax Cut Had to Deal With

The economic advisers who advocated a tax cut had to fight against various difficulties. First of all President Kennedy, himself, had to be convinced of a tax reduction. When they finally had convinced him, the President then had to convince Congress of the necessity of a tax cut.

In the summer of 1961, Congress nearly passed a tax increase of $ 3 billion to finance the Berlin buildup, in spite of the still-yawning gap between the economy's actual and potential performance. Sorensen describes the attitude in the White House toward this proposal in the following way:

> The President liked it as a means of requiring all Americans to share the burden of the crisis as well as those called to active duty. The Attorney General liked it as an answer to those asking what they could do for their country. The foreign policy makers liked it as a clear demonstration of America's determination. Secretary Dillon, though with some reluctance, at first liked it as a step toward the principle of balanced budgets. Senate Leader Mansfield liked it - both "sound policy and sound politics," he told the President - and saw no reason to limit it to one year. Only the economic advisers were against it, arguing that taxes were already too high for solid growth.[31]

Since 1962 the Council of Economic Advisers had been urging Kennedy to propose a large tax cut. In May, 1963 the analysis made by Professor Walter W. Heller, Chairman of the Council of Economic Advisers, showed that a tax cut would create 3 million additional jobs and thus open exits from poverty.[32]

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[31] Sorensen, Kennedy, p. 399
[32] Heller, Political Economy, p. 20

In August, 1962 President Kennedy announced that he would propose a major tax bill in 1963. This tax bill would be designed to reduce the tax rates of personal income and corporate profit taxes. The year 1963 saw only debates over this measure and the enactment of the tax bill did not come until February, 1964.

The acceptance of the huge tax cut by Congress was gained in part by claiming:

1. that it was the surest way to achieve a balanced budget in a balanced economy
2. that the debt would drop as a proportion of GNP
3. that rigid frugality would be practiced in the Federal budget.

Although the bill was not enacted before 1964, it can be regarded as an achievement of the Kennedy Administration. The production, or GNP, gap which narrowed from about $ 50 billion in 1961 to $ 30 billion in early 1962, was instrumental in setting the proposed net tax cut at roughly $ 11 billion. The tax cut was also designed to bring the high-employment surplus, which had been reduced to $ 6½ billion by the end of 1962, down to, or close to, zero.[33]

The Council of Economic Advisers urged the government to rely on tax reductions rather than on increases in Federal civilian expenditures. Taxes also have the advantage, if once enacted, that they can go in effect almost immediately through the withholding and current payment system. They are more quickly reversible, too.

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[33] Heller, Political Economy, p. 72

The Effectiveness of the Tax Reduction

In 1964, personal income tax liabilities were cut by $ 6.7 billion and corporate profit tax liabilities by $ 1.7 billion. Withholding rates on wages and salaries were reduced from 18 to 14% in early March, 1964.[34]

From 1963 to 1964, GNP grew 4.5%, after adjustment of price changes. It is suggested that the growth rate would have been only 3% in absence of the tax cut. The tax cut added $ 7.7 billion to disposable income in 1964, and the addition was running at an annual rate of $ 9½ billion by the end of the year. The Council of Economic Advisers estimated that the increase in consumer spending alone from the tax cut's impact was $ 9 billion in 1964 and reached an annual rate of $ 13 billion by the end of the year.[35]

The total gain from the entire tax program was estimated by Arthur M. Okun, a member of the Council of Economic Advisers under President Johnson who made studies concerning the impact of the tax reductions in 1964 upon the economy, as over $ 16 billion by the end of 1964, nearly $ 25 billion by the mid-1965, and over $ 30 billion by the end of 1965. Altogether, the GNP gain was some $ 36 billion. Of this amount, about $ 8 billion were fixed investment and $ 28 billion were consumption. Of the total GNP change, about three-quarters are credited to the personal tax cut and one-quarter to the corporate tax cut. By the end of 1964, disposable income was estimated, by Okun, to have

34/ and 35/U.S., President, Economic Report, Jan., 1965, p. 65

been \$ 15.1 billion higher as a result of the tax cut and consumption to have been \$ 10.5 billion higher.[36]

Between the first quarters of 1964 and 1966, there was a rise in GNP by 16.9%, which made a 13.5% rise in Government expenditures at lower average tax rates possible.

> And until Vietnam intervened, the tax cut had brought us back to a "balanced budget in a balanced economy" - in fact, by the first half of 1965, Federal receipts had already risen \$ 7½ billion above their pre-tax-cut levels, and the Federal Budget (NIA basis) was in surplus.[37]

There exists no consensus about the effectiveness of the tax cut. Although Arthur Okun's analysis claims that, in the absence of the 1964 tax cut, GNP for the second quarter of 1965 would have been \$ 24½ billion below its actual level, Milton Friedman[38] believes that the economy started again because of a more expansionary monetary policy.

On the other hand, there remains the fact that consumption spending grew an average of \$ 4.4 billion during the last three quarters preceding the tax cut, while it jumped to an average of \$ 8.4 billion per quarter during the three quarters following the tax cut.

36/ Canterbery, Economics on a New Frontier, pp. 272-73
37/ Heller, Political Economy, p. 73
38/ Fridman and Heller, Monetary vs. Fiscal Policy

CHAPTER IV

FINAL REMARKS

Short Summary of Economic Developments During 1961 to 1963

From the first quarter of 1961 to the fourth quarter of 1963, total Federal expenditures increased by \$ 17 billion, or roughly 17%. Those expenditures, undertaken primarily to strengthen defense and space programs, directly raised the level of aggregate demand and were highly stimulating to the rest of the economy.

In 1962 two tax measures were adopted to provide a needed long-run stimulus to lagging investment. New depreciation guidelines were announced in July, 1962, and an investment tax credit was enacted by Congress in the Revenue Act of 1962. The net effect of these two measures was to increase by \$ 2½ billion the annual cash flow to corporations and to increase the after-tax rate return on new investment.

Through a combination of expenditure increases and tax reductions, the full-employment surplus was reduced to about \$ 6½ billion in 1962. But a major expansionary fiscal action was needed to strengthen and sustain the upswing. Thus, in August, 1962, President Kennedy announced that a major tax cut would be proposed to accelerate the economy's progress toward full employment. However, Congressional action on the proposed tax cut was not completed in 1963.

By the fourth quarter of 1963 the full-employment surplus had reached

$ 11 billion, and at the same time, output remained short of potential and the unemployment rate was at 5.6% of the labor force.

The period from 1961 to 1963 was the longest and strongest expansion since World War II, as the output of goods and services increased more in these years than it had in the previous years. The rate of national economic growth in 1960 was less than 3%. The three-year average during 1961-1963 was nearly double that level. By the end of 1963 a record of $ 100 billion increase in GNP since 1961 which represented a 16% growth in national real output had provided more than 2½ million jobs and a record rise in labor income. GNP increased by 20% (current prices) from the first quarter of 1961 to the fourth quarter of 1963 - from $ 500.4 billion to $ 600.0 billion.

This increase in total demand brought a 16% increase in real output, and only a 4% rise in prices. The average annual rate of increase in the consumer price index amounted to a very moderate 1.2%.[39]

This price stability of the Kennedy years is due to the high productivity gains and to the modest increases in wage rates.

The U.S. economy from 1960 to 1965 experienced, as Walter W. Heller describes it:

> - an expansion that in its first five years created over seven million new jobs, doubled profits, increased the nation's real output by a third, and closed the $ 50 billion gap between actual and potential production that plagued the American economy in 1961.[40]

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[39] U.S., President, Economic Report, Jan., 1964, p. 35
[40] Heller, Political Economy, p. 1

Some Critical Remarks With Respect to the Fiscal Policy of the Kennedy Administration

Tax reduction was regarded as the major tool to bring about full employment and more economic growth. While many, like Heller, advocated this policy, others, like Jacoby and Friedman, thought that the goals of full employment and economic growth could be achieved through a greater reliance on monetary policy.

The primary criticism by Jacoby was, that the tax cut concentrated the preponderance of all tax reductions on low-bracket personal incomes, where its ultimate effects in expanding aggregate demand are likely to be modest. The employment-generating effects of tax-rate reduction could be much larger by concentrating on the corporate tax rate.

There was growth in the economy but it was comparatively slow. The growth of the economy was due primarily to a deficiency of domestic private investment. The official argument was that "excess" productive capacity must be taken up by higher consumer demand before the level of business investment will rise. This has been proved as false in the steel and other industries. Neil H. Jacoby concludes:

> It appears clear, however, that a radical overhauling of the Federal income tax structure in the direction of lower, less progressive rates applied to a broader segment of personal income would have a much more powerful influence upon economic growth than any fiscal action during 1961-1963.[41]

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[41] Jacoby, "Fiscal Policy", p. 367

There are mainly three things which are criticized:

1. The Kennedy-Johnson Administration has not acted vigorously enough to curb and reduce some government spending programs.
2. Its emphasis in the tax reduction programs on personal instead of corporate tax cuts is inconsistent with its avowed aim to faster economic growth.
3. It has not put in motion enough machinery to resolve the explosive problems of Federal-Local-State financial relations which were to come in the following years.

Walter D. Fackler[42], as well as Milton Friedman, criticized the heavy reliance on fiscal policy instead on monetary policy.

> A tax cut may provide some short-run stimulus, and so may budget deficits, depending on how they are produced and how they are financed. But rely upon the fiscal manipulations now advertised to replace the monetary growth necessary to finance a higher level of economic activity seems to me to be both bad economics and wishful thinking - and a valid cause for pessimism about the immediate future.[43]

42/ Walter D. Fackler is associate professor of business economics and associate dean, Graduate School of Business, University of Chicago.

43/ Walter D. Fackler, "Business Spending and Government Fiscal Policy", Journal of Business, XXXVI (Jan., 1963), p. 3

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FISCAL POLICY DURING THE KENNEDY ADMINISTRATION (1961-1963)

by

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AN ABSTRACT OF A MASTER'S REPORT

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The objective of this report was to review the literature about the fiscal policies of the Kennedy Administration. This paper has considered fiscal measures and their effectiveness during the three-year period from 1961 to 1963.

The report has been divided into four main parts. The first chapter, Introduction, gives a survey of the report, and explains what is meant by fiscal policy. Chapter II, The Fight Against Recession, deals with the fiscal actions taken by the Kennedy Administration. The first two parts of that chapter have been designed in such a way that they explain the problems Kennedy had to face and the first measures his administration undertook to solve them. The description of the policy in 1961 went more or less into detail. In the following two parts Federal expenditures throughout the whole period have been regarded, as well as the tax measures designed to stimulate investment. The last part of chapter II summarizes the economic developments from 1961 to 1963.

Chapter III deals with the tax reduction, a measure which was initiated during the Kennedy Administration and enacted under President Johnson. The Kennedy Administration can be given part credit for it. In order to judge the effectiveness of the tax cut, the years 1964 and 1965 had to be considered.

Chapter IV gives a final summary of the period 1961-1963, and as the fiscal policies under President Kennedy also had their effect upon later years, economic developments up to 1965 have been mentioned. Included in the last chapter are opinions of various writers about the effectiveness of the fiscal measures of the Kennedy Administration.

From the first quarter of 1961 to the fourth quarter of 1963, total

Federal expenditures increased by \$ 17 billion, or roughly 17%. Those expenditures, undertaken primarily to strengthen defense and space programs, directly raised the level of aggregate demand and were highly stimulating to the rest of the economy.

In 1962 two tax measures were adopted to provide a needed long-run stimulus to lagging investment. New depreciation guidelines were announced in July, 1962, and an investment tax credit was enacted by Congress in the Revenue Act of 1962. The net effect of these two measures was to increase by \$ 2½ billion the annual cash flow to corporations and to increase the after-tax rate return on new investment.

Through a combination of expenditure increases and tax reductions, the full-employment surplus was reduced to about \$ 6½ billion in 1962. But a major expansionary fiscal action was needed to strengthen and sustain the upswing. Thus, in August 1962, President Kennedy announced that a major tax cut would be proposed to accelerate the economy's progress toward full employment. However, Congressional action on the proposed tax cut was not completed in 1963.

By the fourth quarter of 1963 the full-employment surplus had reached \$ 11 billion, and at the same time, output remained short of potential and the unemployment rate was at 5.6% of the labor force.

Finally, the tax cut was enacted in 1964 under President Johnson. Personal tax liabilities were cut by \$ 6.7 billion and corporate tax liabilities by \$ 1.7 billion. The total gain from the entire tax program was estimated by Okun as over \$ 16 billion by the end of 1964, nearly \$ 25 billion by the mid-1965, and over \$ 30 billion by the end of 1965. Altogether, the GNP gain was some \$ 36 billion. Of the total GNP change, about three-quarters have been credited to the personal tax cut and one-quarter to the corporate tax cut.