Number 61 of a series of photographs of past presidents of the Association.

The American Economic Review

VOLUME L MARCH 1960 NUMBER ONE

PROGRESS TOWARDS ECONOMIC STABILITY*

By Arthur F. Burns

The American people have of late been more conscious of the business cycle, more sensitive to every wrinkle of economic curves, more alert to the possible need for contracyclical action on the part of government, than ever before in our history. Minor changes of employment or of productivity or of the price level, which in an earlier generation would have gone unnoticed, are nowadays followed closely by laymen as well as experts. This sensitivity to the phenomena of recession and inflation is a symptom of an increased public awareness of both the need for and the attainability of economic progress. It is precisely because so much of current industrial and governmental practice can be better in the future that our meetings this year are focused on the broad problem of improving the performance of the American economy. However, as we go about the task of appraisal and criticism, it will be well to discipline our impatience for reform. In the measure that we avoid exaggerating our nation's failures or understanding its successes, we shall make it easier for ourselves as well as for economists in other countries to see current needs and developments in a just perspective.

It is a fact of the highest importance, I think, that although our economy continues to be swayed by the business cycle, its impact on the lives and fortunes of individuals has been substantially reduced in our generation. More than twenty-five years have elapsed since we last experienced a financial panic or a deep depression of production and employment. Over twenty years have elapsed since we last had a severe business recession. Between the end of the second world war and the present, we have experienced four recessions, but each was a relatively

* Presidential address delivered at the Seventy-second Annual Meeting of the American Economic Association, Washington, D.C., December 28, 1959. The author is indebted to his colleagues—M. Abramovitz, S. Fabricant, M. Friedman, Jane Kennedy, L. Wolman, and especially G. H. Moore—for counsel and criticism in the preparation of this paper.

mild setback. Since 1937 we have had five recessions, the longest of which lasted only 13 months. There is no parallel for such a sequence of mild—or such a sequence of brief—contractions, at least during the past hundred years in our own country.

Nor is this all. The character of the business cycle itself appears to have changed, apart from the intensity of its over-all movement. We usually think of the business cycle as a sustained advance of production, employment, incomes, consumption, and prices, followed by a sustained contraction, which in time gives way to a renewed advance of aggregate activity beyond the highest levels previously reached. We realize that changes in the price level occasionally outrun changes in production, that employment is apt to fluctuate less than production, and that consumption will fluctuate still less; but we nevertheless think of their movements as being roughly parallel. This concept of the business cycle has always been something of a simplification. For example, during the early decades of the nineteenth century, when agriculture dominated our national economy, occasional declines in the physical volume of production, whether large or small, had little effect on the number of jobs and sometimes had slight influence even on the flow of money incomes. As agriculture diminished in importance, the nation's production, employment, personal income, consumption, and price level fell more closely into step with one another and thus justified our thinking of them as moving in a rough parallelism. In recent years, however, and especially since the second world war, the relations among these movements have become much looser.

The structure of an economy inevitably leaves its stamp on the character of its fluctuations. In our generation the structure of the American economy has changed profoundly, partly as a result of deliberate economic policies, partly as a result of unplanned developments. In considering problems of the future, we can proceed more surely by recognizing the changes in economic organization which already appear to have done much to blunt the impact of business cycles.

I

In the early decades of the nineteenth century the typical American worker operated his own farm or found scope for his energy on the family farm. Governmental activities were very limited. What there was of industry and commerce was largely conducted through small firms run by capitalist-employers. Corporations were rare and virtually confined to banking and transportation. As the population grew and capital became more abundant, individual enterprise expanded vigorously but corporate enterprise expanded still more. An increasing part of the nation's business therefore came under the rule of corporations.

By 1929, the output of corporate businesses was already almost twice as large as the output of individual proprietorship and partnerships. The gap has widened appreciably since then. Corporate profits have therefore tended to increase faster than the incomes earned by proprietors, who still remain very numerous in farming, retail trade, and the professions. Fifty years ago the total income of proprietors was perhaps two and a half times as large as the combined sum of corporate profits and the compensation of corporate officers. By 1957 this corporate aggregate exceeded by a fourth the income of all proprietors and by two-thirds the income of proprietors outside of farming.

The great growth of corporations in recent decades has occurred preponderantly in industries where the firm must operate on a large scale to be efficient and therefore must assemble capital from many sources. But a corporation whose stock is held publicly and widely has a life of its own, apart from that of its owners, and will rarely distribute profits at the same rate as they are being earned. While profits normally respond quickly and sharply to a change in sales and production, the behavior of dividends is tempered by business judgment. In practice, dividends tend to move sluggishly and over a much narrower range than profits. Corporations have therefore come to function increasingly as a buffer between the fluctuations of production and the flow of income to individuals. In earlier times the lag of dividends was largely a result of the time-consuming character of corporate procedures. More recently, the advantages of a stable dividend—especially its bearing on a firm's financial reputation—have gained increasing recognition from business managers. Meanwhile, modern trends of taxation have stimulated corporations to rely more heavily on retained profits and less on new stock issues for their equity funds, and this development in turn has facilitated the pursuit of stable dividend policies. Thus the evolution of corporate practice, as well as the growth of corporate enterprise itself, has served to reduce the influence of a cyclical decline of production and profits on the flow of income to individuals.

The expansion and the means of financing of governmental enterprise, especially since the 1930's, have had a similar effect. The increasing complexity of modern life, a larger concept of the proper function of government, and the mounting requirements of national defense have resulted in sharp increases of governmental spending. Fifty years ago the combined expenditure of federal, state, and local governments was about 7 per cent of the dollar volume of the nation's total output. Governmental expenditures rose to 10 per cent of total output in 1929 and to 26 per cent in 1957. This huge expansion of governmental enterprise naturally led to increases in tax rates and to an energetic search for new sources of revenue. In time, taxes came to be imposed on estates, gifts, employment, sales, and—most important of all—on the incomes of both corporations and individuals. Fifty years ago customs duties still yielded about half of the total revenue of the federal government, and none of our governmental units as yet collected any tax on incomes. Twenty years later, personal and corporate income taxes were already the mainstay of federal finance. Subsequently, the activities of the federal government increased much faster than local activities and taxes followed suit. By 1957 the income tax accounted for nearly 70 per cent of federal revenue, 8 per cent of state and local revenue, and a little over half of the combined revenue of our various governmental units.

This dominance of the income tax in current governmental finance, together with the recent shift of tax collection toward a pay-as-you-go basis, has measurably enlarged the government's participation in the shifting fortunes of the private economy. During the nineteenth century, taxes were not only a much smaller factor in the economy, but such short-run elasticity as there was in tax revenues derived almost entirely from customs duties. Hence, when production fell off and private incomes diminished, the accompanying change in governmental revenues was usually small. In recent years, however, governmental revenues have become very sensitive to fluctuations of business conditions. When corporate profits decline by, say, a billion dollars, the federal government will collect under existing law about a half billion less from corporations. When individual incomes decline by a billion, the federal government may be expected to collect about $150 million less from individuals. State income taxes accentuate these effects. In short, when a recession occurs, our current tax system requires the government to reduce rather promptly and substantially the amount of money that it withdraws from the private economy for its own use. The result is that the income from production which corporations and individuals have at their disposal declines much less than does the national income.

Moreover, the operations of government are now so organized that the flow of personal income from production is bolstered during a recession by increased payments of unemployment insurance benefits. Unemployment insurance was established on a national basis in 1935, and the protection of workers against the hazards of unemployment has increased since then. Not all employees are as yet covered by unemployment insurance and the benefits, besides, are often inadequate to provide for essentials. Nevertheless, there has been a gradual improvement in the ability of families to get along decently even when the main breadwinner is temporarily unemployed. At present, over 80 per cent of those who work for a wage or salary are covered by unemployment insurance, in contrast to 70 per cent in 1940. The period over which benefits can be paid to an unemployed worker has become longer and the typical weekly benefit has risen in greater proportion than the cost of living. Furthermore, arrangements have recently been concluded in several major industries whereby benefits to the unemployed are supplemented from private sources.

Other parts of the vast system of social security that we have devised since the 1930's have also served to support the flow of personal income at times when business activity is declining. Payments made to retired workers kept increasing during each recession of the postwar period. The reason is partly that workers handicapped by old age or physical disability experience greater difficulty at such times in keeping their jobs or finding new ones and therefore apply for pensions in somewhat larger numbers. Another factor has been the intermittent liberalization of statutory benefits. But the most important reason for the steady increase of old-age pensions is the maturing of the social security system. In 1940, only 7 per cent of people of age 65 and over were eligible for benefits from the old-age insurance trust fund, in contrast to 23 per cent in 1948 and 69 per cent in 1958. The trend of other public pension programs and the various public assistance programs has also been upward. Between 1929 and 1957 the social security and related benefits paid out by our various governmental units rose from 1 per cent of total personal income to 6 per cent. In 1933, with the economy at a catastrophically low level, these benefit payments were merely $548 million larger than in 1929. On the other hand, in 1958—when business activity was only slightly depressed—they were $4.4 billion above the level of 1957. Even these figures understate the difference between current conditions and those of a quarter century ago, for they leave out of account the private pensions which are beginning to supplement public pensions on a significant scale.

As a result of these several major developments in our national life, the movement of aggregate personal income is no longer closely linked to the movement of aggregate production. During the postwar period we have had several brief but sizable setbacks in production. For example, in the course of the recession of 1957-58, the physical output of factories and mines fell 14 per cent, the physical output of commodities and services in the aggregate fell 5.4 per cent, and the dollar volume of total output fell 4.3 per cent. In earlier times personal incomes would have responded decisively to such a decline in production. This time the government absorbed a substantial part of the drop in the dollar volume of production by putting up with a sharp decline of its revenues despite the need to raise expenditures. Corporations absorbed another part of the decline by maintaining dividends while their undistributed profits slumped. In the end, the aggregate of personal incomes, after taxes, declined less than 1 per cent and the decline was over before the recession ended.

Although the details have varied from one case to the next, a marked divergence between the movements of personal income and production has occurred in each of the postwar recessions. Indeed, during 1953-54 the total income at the disposal of individuals defied the recession by continuing to increase. This unique achievement was due to the tax reduction that became effective soon after the onset of recession as well as to the structural changes that have reduced the dependence of personal income on the short-run movements of production.

II

When we turn from personal income to employment, we find that the imprint of the business cycle is still strong. During each recession since 1948, unemployment reached a level which, while decidedly low in comparison with the experience of the 'thirties, was sufficient to cause serious concern. But although the fluctuations of employment have continued to synchronize closely with the movements of production, the relation between the two has been changing in ways which favor greater stability of employment in the future.

As the industrialization of our economy proceeded during the nineteenth century, an increasing part of the population became exposed to the hazards of the business cycle. Manufacturing, mining, construction, freight transportation—these are the strategic industries of a developing economy and they are also the industries in which both production and jobs have been notoriously unstable. Shortly after the Civil War, the employees attached to this cyclical group of industries already constituted 23 per cent of the labor force. Employees of industries that have remained relatively free from cyclical unemployment—that is, agriculture, merchandising, public utilities, financial enterprises, the personal service trades, and the government—accounted for another 32 per cent. The self-employed in farming, business, and the professions, whose jobs are especially steady, made up the rest or 45 per cent of the work force. This was the situation in 1869. Fifty years later, the proportion of workers engaged in farming, whether as operators or hired hands, had shrunk drastically, and this shrinkage was offset only in part by the relative gain of other stable sources of employment. Consequently, the proportion of employees in the cyclical industries kept rising, decade after decade, and reached 36 per cent in 1919.

Clearly, the broad effect of economic evolution until about 1920 was to increase the concentration of jobs in the cyclically volatile industries, and this was a major force tending to intensify declines of employment during business contractions. Since then, the continued progress of technology, the very factor which originally was mainly responsible for the concentration in the cyclical industries, has served to arrest this tendency. The upward trend of production in manufacturing and the other highly cyclical industries has remained rapid in recent decades. However, advances of technology have come so swiftly in these industries as well as in agriculture that an increasing part of the nation's labor could turn to the multitude of tasks in which the effectiveness of human effort improves only slowly, where it improves at all. Thus the employees of "service" industries constituted 24 per cent of the labor force in 1919, but as much as 44 per cent in 1957. The proportion of self-employed workers in business and the professions, which was 9.4 per cent in the earlier year, became 10.6 per cent in the later year. True, these gains in types of employment that are relatively stable during business cycles were largely canceled by the countervailing trend in agriculture. Nevertheless, the proportion of employees attached to the cyclically volatile industries has not risen since 1919. Or to express this entire development in another way, the proportion of workers having rather steady jobs, either because they work for themselves or because they are employed in industries that are relatively free from the influence of business cycles, kept declining from the beginning of our industrial revolution until about 1920, and since then has moved slightly but irregularly upward.

Thus, the changing structure of industry, which previously had exercised a powerful destabilizing influence on employment and output, particularly the former, has ceased to do so. The new stabilizing tendency is as yet weak, but it is being gradually reinforced by the spread of "white-collar" occupations throughout the range of industry. For many years now, the proportion of people who work as managers, engineers, scientists, draftsmen, accountants, clerks, secretaries, salesmen, or in kindred occupations has been increasing. The white-collar group, which constituted only 28 per cent of the labor force outside of agriculture in 1900, rose to 38 per cent in 1940 and to 44 per cent in 1957. Workers of this category are commonly said to hold a "position" rather than a "job" and to be paid a "salary" rather than a "wage." Hence, they are often sheltered by a professional code which frowns upon frequent firing and hiring. Moreover, much of this type of employment is by its nature of an overhead character and therefore less responsive to the business cycle than are the jobs of machine operators, craftsmen, assembly-line workers, truck drivers, laborers, and others in the "blue-collar" category. For example, during the recession of 1957-58, the number of "production workers" employed in manufacturing, who approximate the blue-collar group, declined 12 per cent, while the employment of "nonproduction workers," who approximate the white-collar group, declined only 3 per cent. This sort of difference has been characteristic of recessions generally, not only the most recent episode, and on a smaller scale it has also been characteristic of industry generally, not only of manufacturing.

It appears, therefore, that changes in the occupational structure of the labor force, if not also in the industrial structure, have been tending of late to loosen the links which, over a considerable part of our economic history, tied the short-run movement of total employment rather firmly to the cyclical movement of total production, and especially to the cyclical movement of its most unstable parts—that is, the activities of manufacturing, mining, construction, and freight transportation. This stabilizing tendency promises well for the future, although up to the present it has not left a mark on records of aggregate employment that is comparable with the imprint that the stabilizing influences we discussed previously have left on personal income. In the postwar period, as over a longer past, the number of men and women at work, and even more the aggregate of hours worked by them, has continued to move in fairly close sympathy with the fluctuations of production.

We can no longer justifiably suppose, however, when employment falls 2 million during a recession, as it did between July 1957 and July 1958, that the number of people who receive an income has declined by any such figure. In fact, the number of workers drawing unemployment insurance under the several regular plans rose about 1.3 million during these twelve months, while the number of retired workers on public pensions rose another million. Hence, it may be conservatively estimated that the number of income recipients increased over 300 thousand despite the recession. In the other postwar recessions our experience was fairly similar. In other words, as a result of some of the structural changes on which I dwelt earlier, the size of the income-receiving population has grown steadily and escaped cyclical fluctuations entirely.[1]

III

Turning next to consumer spending, we must try once again to see recent developments in historical perspective. The fact that stands out is that the impact of business cycles on consumption has recently diminished, while the effects of consumption on the business cycle have become more decisive.

In the classical business cycle, as we came to know it in this country,

[1] This upward trend would appear steeper than I have suggested if recipients of property income and of public assistance were included in the count. In the present context, however, it has seemed best to restrict the income-receiving population to the working class, or more precisely, to members of the labor force or those recently in the labor force who receive an income as a matter of right and on some regular basis.

once business investment began declining appreciably, a reduction of consumer spending soon followed. Sometimes the expansion of investment culminated because the firms of one or more key industries, finding that their markets were growing less rapidly than had been anticipated, made an effort to bring their productive capacity or inventories into better adjustment with sales. Sometimes the expansion culminated because the belief grew that construction and financing costs had been pushed to unduly high levels by the advance of prosperity. Sometimes it culminated for all these or still other reasons. But whatever the cause or causes of the decline in investment, it made its influence felt over an increasing area of the economy. For a while consumer spending was maintained at a peak level or even kept rising. But since businessmen were now buying on a smaller scale from one another, more and more workers lost their jobs or their overtime pay, financial embarrassments and business failures became more frequent, and uncertainty about the business outlook spread to parts of the economy in which sales and profits were still flourishing. If some consumers reacted to these developments by curtailing their spending in the interest of caution, others did so as a matter of necessity. Before long, these curtailments proved sufficient to bring on some decline in the aggregate spending of consumers. The impulses for reducing business investments therefore quickened and the entire round of events was repeated, with both investment and consumption declining in a cumulative process.

As the contraction continued, it tried men's patience, yet in time worked its own cure. Driven by hard necessity, business firms moved with energy to reduce costs and increase efficiency. Consumers whose incomes were declining often saved less or dissaved in order not to disrupt their customary living standards. Hence, even if sales and prices were still falling, profit margins improved here and there. In the meantime, bank credit became more readily available, costs of building and terms of borrowing became more favorable, the bond market revived, business failures diminished, and the investment plans of innovators and others began expanding again. When recovery finally came, it was likely to be led by a reduced rate of disinvestment in inventories or by a new rush to make investments in fixed capital. At this stage of the business cycle, consumer spending was at its very lowest level, if not still declining.

Many of these features of earlier business cycles have carried over to the present. However, the behavior of consumers in the postwar recessions has departed from the traditional pattern in two respects. In the first place, consumers maintained their spending at a high level even after business activity had been declining for some months, so that the tendency of recessions to cumulate was severely checked. During the recession of 1945 consumer spending actually kept increasing. In each of the later recessions it fell somewhat; but the decline at no time exceeded one per cent and lasted only a quarter or two. In the second place, instead of lagging at the recovery stage of the business cycle, as it had in earlier times, consumer spending turned upward before production or employment resumed its expansion. This shift in cyclical behavior appears clearly in department store sales, which have been recorded on a substantially uniform basis for several decades and are widely accepted as a tolerably good indicator of consumer spending. In the recoveries of 1921, 1924, 1927, and 1938, these sales lagged by intervals ranging from two to four months. In 1933 their upturn came at the same time as in production and employment. It thus appears that, during the 1920's and 1930's, consumer spending in no instance led the economy out of a slump. In the postwar period, on the other hand, department store sales have led successive recoveries by intervals stretching from two to five months. Of course, department store sales cover only a small fraction of consumer expenditure, and correction for price changes would alter their historical record somewhat. But the main features of the cyclical behavior of dollar sales by department stores are broadly confirmed by other evidence on consumer spending, which is extensive for recent years. We may therefore conclude with considerable assurance that consumer spending has played a more dynamic role in recent times. Not only have consumers managed their spending during recessions so that the cumulative process of deflation has been curbed, but consumer spending has emerged as one of the active factors in arresting recession and hastening recovery.

This new role of the consumer in the business cycle reflects some of the developments of the postwar period that we considered earlier, particularly the greatly enhanced stability in the flow of personal income, the steady expansion in the number of income recipients, and the relative increase in the number of steady jobs. It reflects also the improvements of financial organization and other structural changes which have strengthened the confidence of people, whether acting as consumers or investors, in their own and the nation's economic future. Whatever may have been true of the past, it can no longer be held that consumers are passive creatures who lack the power or the habit of initiating changes in economic activities. There is no harm in thinking of consumer spending as being largely "determined" by past and current incomes, provided we also recognize that the level of current incomes is itself shaped to a significant degree by the willingness of people to work hard to earn what they need to live as they feel they should. The evidence of rising expectations and increased initiative on the part of consumers is all around us. It appears directly in the rapidly rising proportion of women in the labor force, in the sizable and increasing proportion of men who hold down more than one job, in the slackening of the long-term decline of the average work week in manufacturing despite the increased power of trade unions, as well as indirectly in the improvement of living standards and the great upsurge of population. Indeed, the expansive forces on the side of consumption have been so powerful that we must not be misled by the cyclical responses of consumer spending, small though they were, to which I referred earlier. There are no continuous records of inventories in the hands of consumers; but if such statistics were available, we would almost certainly find that consumption proper, in contrast to consumer spending, did not decline at all during any of the postwar recessions.

In view of these developments in the realm of the consumer, it is evident that the force of any cyclical decline of production has in recent years been reduced or broken as its influence spread through the economy. Production has remained unstable, but the structure of our economy has changed in ways which have limited the effects of recessions on the lives of individuals—on the numbers who receive an income, the aggregate of personal incomes, consumer spending, actual consumption, and to some degree even the numbers employed. It is, therefore, hardly an exaggeration to assert that a good part of the personal security which in an earlier age derived from living on farms and in closely knit family units, after having been disrupted by the onrush of industrialization and urbanization, has of late been restored through the new institutions that have developed in both the private and public branches of our economy.

IV

In concentrating, as I have thus far, on the changes of economic organization which have lately served to reduce the impact of business cycles on the lives of individuals, I have provisionally taken the cyclical movement of production for granted. Of course, if the fluctuations of production had been larger, the impact on people would have been greater. On the other hand, the stabilized tendency of personal income and consumption has itself been a major reason why recent recessions of production have been brief and of only moderate intensity. Many other factors have contributed to this development. Among them are the deliberate efforts made in our generation to control the business cycle, of which I have as yet said little.

In earlier generations there was a tendency for the focus of business thinking to shift from the pursuit of profits to the maintenance of financial solvency whenever confidence in the continuance of prosperity began to wane. At such times experienced businessmen were prone to reason that it would shortly become more difficult to collect from their customers or to raise funds by borrowing, while they in turn were being pressed by their creditors. Under the circumstances it seemed only prudent to conserve cash on hand, if not also to reduce inventories or accounts receivable. Such efforts by some led to similar efforts by others, in a widening circle. As pressure on commodity markets, security markets, and on the banking system mounted, the decline of business activity was speeded and the readjustment of interest rates, particularly on the longer maturities, was delayed. More often than not the scramble for liquidity ran its course without reaching crisis proportions. Sometimes, however, as in 1873, 1893, and 1907, events took a sinister turn. Financial pressures then became so acute that doubts arose about the ability of banks to meet their outstanding obligations and, as people rushed to convert their deposits into currency, even the soundest banks were forced to restrict the outflow of cash. With the nation's system for making monetary payments disrupted, panic ruled for a time over the economy and production inevitably slumped badly.

It was this dramatic phase of the business cycle that first attracted wide notice and stimulated students of public affairs to seek ways and means of improving our financial organization. The Federal Reserve Act, which became law under the shadow of the crisis of 1907, required the pooling of bank reserves and established facilities for temporary borrowing by banks. The hope that this financial reform would ease the transition from the expanding to the contracting phase of business cycles has been amply justified by experience. But the Federal Reserve System could not prevent the cumulation of financial trouble during business expansions. Nor could it prevent runs on banks or massive bank failures, as the Great Depression demonstrated. The need to overhaul and strengthen the financial system became increasingly clear during the 'thirties and led to numerous reforms, among them the insurance of mortgages, the creation of a secondary market for mortgages, the insurance of savings and loan accounts, and—most important of all—the insurance of bank deposits. These financial reforms have served powerfully to limit the propagation of fear, which in the past had been a major factor in intensifying slumps of production.

But more basic than the financial innovations or any other specific measures of policy has been the change in economic and political attitudes which took root during the 'thirties. The economic theory that depressions promote industrial efficiency and economic progress lost adherents as evidence accumulated of the wreckage caused by unemployment and business failures. The political belief that it was best to leave business storms to blow themselves out lost its grip on men's minds as the depression stretched out. In increasing numbers citizens in all walks of life came around to the view that mass unemployment was intolerable under modern conditions and that the federal government has a continuing responsibility to foster competitive enterprise, to prevent or moderate general economic declines, and to promote a high and rising level of employment and production. This new philosophy of intervention was articulated by the Congress in the Employment Act of 1946, which solemnly expressed what had by then become a national consensus.

In recent times, therefore, the business cycle has no longer run a free course and this fact has figured prominently in the plans of businessmen as well as consumers. During the 1930's, when the objectives of social reform and economic recovery were sometimes badly confused, many investors suspected that contracyclical policies would result in narrowing the scope of private enterprise and reducing the profitability of investment. These fears diminished after the war as the government showed more understanding of the need to foster a mood of confidence so that enterprise, innovation, and investment may flourish. In investing circles, as elsewhere, the general expectation of the postwar period has been that the government would move with some vigor to check any recession that developed, that its actions would by and large contribute to this objective, and that they would do so in a manner that is broadly consistent with our national traditions. This expectation gradually became stronger and it has played a significant role in extending the horizons of business thinking about the markets and opportunities of the future. The upsurge of population, the eagerness of consumers to live better, the resurgence of Western Europe, the revolutionary discoveries of science, and the steady flow of new products, new materials, and new processes have added impetus to the willingness of investors to expend huge sums of capital on research and on the improvement and expansion of industrial plant and equipment. Some of these influences have also been effective in augmenting public investment. The fundamental trend of investment has therefore been decidedly upward. The private part of investment has continued to move cyclically; but it is now a smaller fraction of total national output and it has displayed a capacity to rebound energetically from the setbacks that come during recessions.

The specific measures adopted by the government in dealing with the recessions of the postwar period have varied from one case to the next. In all of them, monetary, fiscal, and housekeeping policies played some part, with agricultural price-support programs assuming special prominence in one recession, tax reductions in another, and increases of public expenditure in still another. Taking a long view, the most nearly consistent part of contracyclical policy has been in the monetary sphere. Since the early 1920's, when the Federal Reserve authorities first learned how to influence credit conditions through open-market operations, long-term interest rates have tended to move down as soon as the cyclical peak of economic activity was reached, in contrast to the long lags that were characteristic of earlier times. Since 1948 the decline of long-term interest rates in the early stages of a recession has also become more rapid. This change in the cyclical behavior of capital markets reflects the increased vigor and effectiveness of recent monetary policies. Inasmuch as optimism, as a rule, is still widespread during the initial stages of an economic decline, a substantial easing of credit, provided it comes early enough, can appreciably hasten economic recovery. This influence is exerted only in part through lower interest rates. Of greater consequence is the fact that credit becomes more readily available, that the money supply is increased or kept from falling, that the liquidity of financial assets is improved, and that financial markets are generally stimulated. The effects of easier credit are apt to be felt most promptly by smaller businesses and the home-building industry, but they tend to work their way through the entire economy. There can be little doubt that the rather prompt easing of credit conditions, which occurred during recent setbacks of production, was of some significance in keeping their duration so short.

Business firms have also been paying closer attention to the business cycle, and not a few of them have even tried to do something about it. These efforts have been expressed in a variety of ways—through the adoption of long-range capital budgets, closer control of inventories, and more energetic selling or some relaxation of credit standards in times of recession. I do not know enough to assess either the extent or the success of some of these business policies. Surely, business investment in fixed capital has remained a highly volatile activity—a fact that is sometimes overlooked by concentrating attention on years instead of months and on actual expenditures instead of new commitments. There is, however, strong evidence that the businessmen of our generation manage inventories better than did their predecessors. The inventory-sales ratio of manufacturing firms has lately averaged about a fourth less than during the 1920's, despite the increased importance of the durable goods sector where inventories are especially heavy. The trend of the inventory-sales ratio has also moved down substantially in the case of distributive firms. This success in economizing on inventories has tended to reduce the fluctuations of inventory investment relative to the scale of business operations and this in turn has helped to moderate the cyclical swings in production. Not only that, but it appears that the cyclical downturns of both inventories and inventory investment have tended to come at an earlier stage of the business cycle in the postwar period than they did previously, so that any imbalance between inventories and sales could be corrected sooner. Since consumer outlays—and often also other expenditures—were well maintained during the recent recessions of production, the rising phase of inventory disinvestment ceased rather early and this naturally favored a fairly prompt recovery of production.

Thus, numerous changes in the structure of our economy have combined to stimulate over-all expansion during the postwar period and to keep within moderate limits the cyclical declines that occurred in production. Indeed, there are cogent grounds for believing that these declines were even more moderate than our familiar statistical records suggest. The line of division between production for sale and production for direct use does not stand still in a dynamic economy. In the early decades of the industrial revolution an increasing part of our production was, in effect, transferred from the home to the shop and factory. This trend has continued in the preparation of foods, but in other activities it appears on balance to have been reversed. The great expansion of home ownership, the invention of all sorts of mechanical contrivances for the home, longer vacations, the general eagerness for improvement, if not also the income tax, have stimulated many people to do more and more things for themselves. Consumers have become equipped to an increasing degree with the capital goods they need for transportation, for the refrigeration of food, for the laundering of clothes, as well as for entertainment and instruction. They have also been doing, on an increasing scale, much of the carpentry, painting, plumbing, and landscaping around their homes. Such activities of production are less subject to the business cycle than the commercial activities which enter statistical reports. Yet these domestic activities have undoubtedly been expanding rapidly, and perhaps expanding even more during the declining than during the rising phase of the business cycle. Hence, it is entirely probable that the cyclical swings of production have of late been smaller, while the average rate of growth of production has been higher, than is commonly supposed.

V

It is in the nature of an economic vocabulary to change slowly, when it changes at all. We keep speaking of the price system, the business cycle, capitalism, socialism, communism, and sometimes we even refer to the "inherent instability" of capitalism or of communism; but the reality that these terms and phrases are intended to denote or sum up does not remain fixed. I have tried to show how a conjuncture of structural changes in our economy has served to modify the business cycle of our times. Some of these changes were planned while others were unplanned. Some resulted from efforts to control the business cycle while others originated in policies aimed at different ends. Some arose from private and others from public activities. Some are of very recent origin and others of long standing. The net result has been that the intensity of cyclical swings of production has become smaller. The links that previously tied together the cyclical movements of production, employment, personal income, and consumption have become looser. And, as everyone knows, the once familiar parallelism of the short-term movements in the physical volume of total production, on the one hand, and the average level of wholesale or consumer prices, on the other, has become somewhat elusive.

To be sure, special factors of an episodic character played their part in recent business cycles, as they always have. For example, a pent-up demand for civilian goods was highly significant in checking the recession of 1945. The tax reduction legislated in April 1948 helped to moderate the recession which began towards the end of that year. The tax cuts announced soon after business activity began receding in 1953 merely required executive acquiescence in legislation that had been passed before any recession was in sight. Again, the sputniks spurred the government's response to the recession of 1957-58. Special circumstances such as these undoubtedly weakened the forces of economic contraction at certain times; but they also strengthened them at other times. In particular, governmental purchases from private firms have not infrequently been an unsettling influence rather than a stabilizing force. We need only recall the drop of federal expenditure on commodities and services from an annual rate of $91 billion in the early months of 1945 to $16 billion two years later, or the fall from $59 billion to $44 billion soon after the Korean hostilities came to a close. The ability of our economy to adjust to such major disturbances without experiencing a severe or protracted slump testifies not only to our good luck; it testifies also to the stabilizing power of the structural changes that I have emphasized.

It seems reasonable to expect that the structural changes in our economy, which have recently served to moderate and humanize the business cycle, will continue to do so. The growth of corporations is not likely to be checked, nor is the tendency to pay fairly stable dividends likely to be modified. The scale of governmental activities will remain very extensive, and so it would be even if the communist threat to our national security were somehow banished. Our methods of taxation might change materially, but the income tax will remain a major source of governmental revenue. Governmental expenditures might fluctuate sharply, but they are not likely to decline during a recession merely because governmental revenues are then declining. The social security system is more likely to grow than to remain stationary or contract. Private pension arrangements will multiply and so also may private supplements to unemployment insurance. Our population will continue to grow. The restlessness and eagerness of consumers to live better is likely to remain a dynamic force. Research and development activities will continue to enlarge opportunities for investment. Governmental efforts to promote a high and expanding level of economic activity are not likely to weaken. Private businesses will continue to seek ways to economize on inventories and otherwise minimize the risk of cyclical fluctuations in their operations. Employment in agriculture is already so low that its further decline can no longer offset future gains of the service industries on the scale experienced in the past. The spread of white-collar occupations throughout the range of industry will continue and may even accelerate. For all these reasons, the business cycle is unlikely to be as disturbing or troublesome to our children as it once was to us or our fathers.

This is surely a reasonable expectation as we look to the future. Yet, it is well to remember that projections of human experience remain descriptions of a limited past no matter how alluringly they are expressed in language of the future. A lesson of history, which keeps resounding through the ages, is that the most reasonable of expectations sometimes lead nations astray. If my analysis is sound, it supports the judgment that the recessions or depressions of the future are likely to be appreciably milder on the average than they were before the 1940's. It supports no more than this. In view of the inherent variability of business cycles and our still somewhat haphazard ways of dealing with them, there can be no assurance that episodic factors will not make a future recession both longer and deeper than any we experienced in the postwar period.

Nor can there be any assurance that the conjuncture of structural changes on which I have dwelt will not be succeeded by another which will prove less favorable to economic stability. For example, although the stabilizing influence of the rising trend of white-collar employment in manufacturing has been more than sufficient to offset the cyclically intensifying influence of a greater concentration of employment in the durable goods sector, the balance of forces might be tipped the other way in the future. This could happen all the more readily if, as white-collar work continues to grow, the need to cut costs during a recession should make this type of employment less stable than it has been. Again, our exports in recent decades have tended to intensify the business cycle somewhat, and this factor may become of larger significance.

Also, it still remains to be seen whether the rising trend of prices—to say nothing of the rapidly growing consumer and mortgage debt—may not serve to complicate future recessions.

A generation ago many economists, having become persuaded that our economy had reached maturity, spoke grimly of a future of secular stagnation. Parts of their analysis were faulty and their predictions have proved wrong; yet their warning helped to mobilize thought and energy to avert the danger of chronic unemployment. Of late, many economists have been speaking just as persuasively, though not always as grimly, of a future of secular inflation. The warning is timely. During the postwar recessions the average level of prices in wholesale and consumer markets has declined little or not at all. The advances in prices that customarily occur during periods of business expansion have therefore become cumulative. It is true that in the last few years the federal government has made some progress in dealing with inflation. Nevertheless, wages and prices rose appreciably even during the recent recession, the general public has been speculating on a larger scale in common stocks, long-term interest rates have risen very sharply since mid-1958, and the yield on stocks relative to bonds has become abnormally low. All these appear to be symptoms of a continuation of inflationary expectations or pressures.

Such developments have often led to economic trouble. They could do so again even if our balance of payments on international account remained favorable. That, however, has not been the case for some time. The "dollar shortage" which influenced much of our economic thinking and practice during the past generation seems to have ended. The economies of many areas of the Free World, especially of Western Europe and Japan, have lately been rebuilt and their competitive power has been restored. This re-establishment of competitive and monetary links between our country and others may cause us some inconvenience, but it is basically a promising development for the future. It should stimulate our economic growth as well as contribute to the economic progress and political stability of other nations of the Free World. Our financial policies, however, will gradually need to be adjusted to the changed international environment. Although our gold stocks are still abundant and the dollar is still the strongest currency in the world, we can no longer conduct our economic affairs without being mindful of gold, or of the short-term balances that foreign governments and citizens have accumulated here, or of the levels of labor costs, interest rates, and prices in our country relative to those in other nations. Unless the deficit in our balance of payments is soon brought under better control, our nation's ability to pursue contracyclical policies during a business recession may be seriously hampered.

We are living in extraordinarily creative but also deeply troubled times. One of the triumphs of this generation is the progress that our nation has made in reducing economic instability. In the years ahead, no matter what we do as a people, our economy will continue to undergo changes, many of which were neither planned nor anticipated. However, the course of events, both domestic and international, will also depend—and to a large degree—on our resourcefulness and courage in deliberately modifying the structure of our economy so as to strengthen the forces of growth and yet restrain instability.

Great opportunities as well as difficult problems face our nation. Monopoly power, which is still being freely exercised despite all the exhortation of recent years, can be curbed by moving toward price and wage controls or, as many economists still hope, by regenerating competition. Higher protective tariffs, import quotas, and "Buy American" schemes can be embraced or, as many economists hope, avoided. A tax structure that inhibits private investment and directs people's energy into activities that contribute little to the nation's economic strength can be retained or reformed. Costly farm surpluses can be further encouraged by government or discontinued. The problems posed by the slums and the inefficient transportation of many of our cities can be neglected or attacked with some zeal. The inadequacy of our unemployment insurance system can be ignored until the next recession or corrected while there is opportunity for a judicious overhauling. In general, our governmental authorities can deal with recessions by trusting to improvisations of public spending, which often will not become effective until economic recovery is already under way, or by providing in advance of any recession for fairly prompt and automatic adjustment of income tax rates to a temporarily lower level of economic activity. The coordination of governmental policies, which may make the difference between success and failure in promoting our national objectives, can be left largely to accidents of personal force and ingenuity or it can be made systematic through an economic policy board under the chairmanship of the President. These and other choices will have to be made by the people of the United States; and economists—far more than any other group—will in the end help to make them.