

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

March 17, 1961

MEMORANDUM FOR THE PRESIDENT

From : Walter W. Heller

Subject: The Economics of the Second-Stage Recovery Program

To help crystallize thinking on the economics of the second-stage recovery program, we have prepared the attached memorandum, "A Second Look at Economic Policy for 1961." In the immediate context, it is designed to serve a triple purpose: (1) as background for our prospective meeting with Paul Samuelson next Tuesday afternoon, (2) as grist for the mill in the Sorenson-Bell-Heller et al review of the whole second-stage problem, and (3) as a possible influence on the tone of the forthcoming Budget Message (i.e., in not foreclosing possible further expansionary recommendations).

Essentially, the memo examines the case for a "do it now" rather than an "explain it later" policy. No matter whether we have a Hodges, Dillon, Goldberg, or Heller upturn, we will still face a yawning production gap and large unemployment. What kind of a program would it take to come reasonably close to closing this gap in the next year? What are some of its economic and political implications?

This is, of course, more than just a hypothetical exercise. It presents the kind of a program we would urge on economic grounds if no political holds were barred. Indeed, at points we endanger (or perhaps confirm) our amateur status as politicians by venturing that good economics may not be bad politics.

The memo makes the following major points:

1. The April review will show that we are still in serious economic trouble, even if an upturn is in the making. Surely, it will not show that we have narrowed the "production gap" that has only recently been opened to public view. In fact, the initial and tentative estimate of GNP for the 1st quarter 1961, just received from Commerce, shows a drop from \$503.5 billion in the last quarter of 1960 to \$498.0 billion in the current quarter (a drop of \$10 billion, in constant dollars, since a year ago).
2. Even if all of your programs are enacted, GNP at the end of 1961 would still be about \$40 billion below potential, and unemployment would still

be about where it is today (subject to the usual hazards of economic forecasting).

3. To illustrate what an aggressive fiscal policy can accomplish, suppose we were to increase government expenditures and temporarily cut taxes to produce a \$10 billion deficit in fiscal 1962. The production gap would be nearly \$20 billion smaller by the end of the year, and by this time next year, unemployment would be down to 5 percent or less as against well over 6 percent if we simply carry through the existing program.
4. We do not blink the problem of public understanding and acceptance of this bold program--the only chance of solving this problem would be by some massive educational efforts of the "fireside chat" type. But the bold program, if adopted and successful, would speak for itself. If rejected, the onus would lie outside the White House.

Attachment