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6

The 1954-1958 Cycle

The preceding analysis of the pre-1914 and the 1921-1938 periods has revealed certain characteristic tendencies in the behavior of government receipts during business cycles. As we shall see in the next section, these tendencies are upset when war intervenes, and are only gradually restored. The business cycle of 1954-1958, however, provides a good test of the persistence of the earlier peacetime relationships. World War II had long since ended, and although the Korean War was still fresh in memory it no longer dominated the situation as it did in 1950-1953.

The 1954-1958 business cycle began with a trough in August 1954, reached its peak in July 1957, and terminated with a trough in April 1958. The expansion phase lasted 35 months, the contraction phase 9. Chart 20 shows how federal receipts, expenditures, and net surpluses and deficits behaved when viewed in the nine-stage business cycle framework, together with the patterns of gross national product and bank debits outside New York (the latter enabling comparisons to be made with cycles prior to 1921).

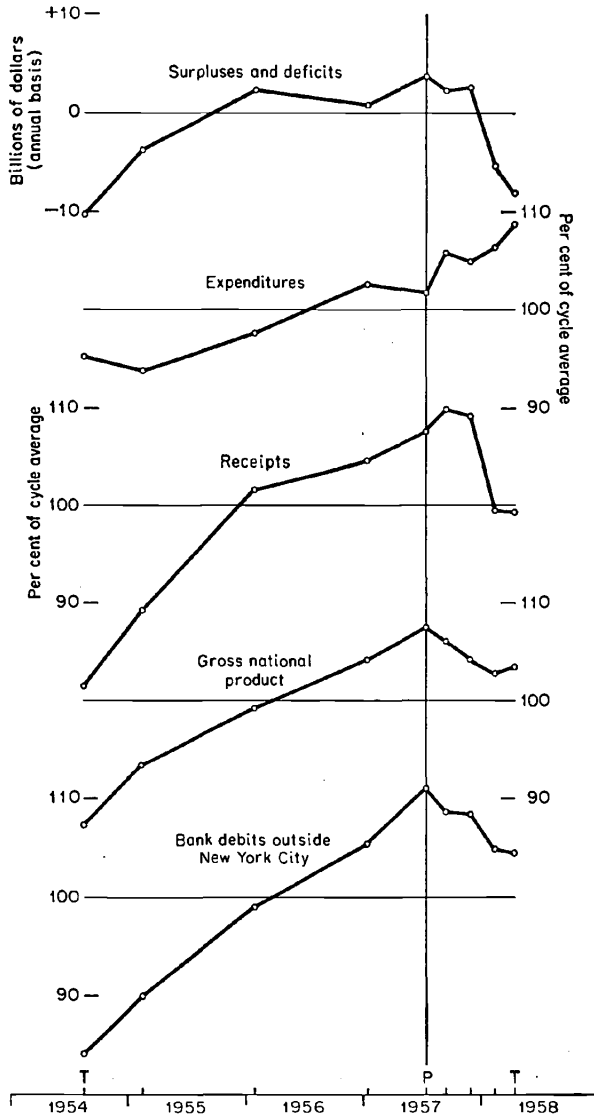
It is clear that the patterns bear a family resemblance to those obtained for 1879-1914 and 1921-1938 (cf. Charts 6, 7, and 8). Federal government finance, however, has become a much more important factor in the economy than it was in the earlier periods. The existence of such built-in stabilizers as unemployment compensation and agricultural price supports on the expenditure side and the closer coordination between income tax payments and earnings on the revenue side serves to accentuate the cyclical patterns. There is also a greater readiness on the part of the government to accept deficits resulting not only from revenues reduced by the cyclical shrinkage in the tax base, but also by tax reductions designed to alleviate the effects of business recession. The government has also adopted measures to combat recession by accelerating and enlarging expenditures.

During 1954-1958, receipts corresponded closely with business conditions, as they did in earlier cycles. Expenditures rose irregularly throughout the

The 1954-1958 Cycle

CHART 20

Federal Surpluses and Deficits, Expenditures, and Receipts, Gross National Product, and Bank Debts Outside New York City, Reference Cycle Patterns, 1954-1958



Source: Federal surpluses and deficits (averages on annual basis), expenditures, and receipts from Table A-5, Sections A2, B, and C, respectively; Gross national product, Table A-6, bank debts outside New York City, Table A-8, Section B.

The 1954-1958 Cycle

cycle, in a manner not unlike that of earlier cycles (cf. Charts 6 and 7). Hence, the deficit with which the cycle began became a net surplus as the business expansion developed, but dwindled again to a deficit during the business contraction. The deficit was destined to become much larger after recovery got under way owing to the sharp rise in expenditures undertaken, in part, because of the recession.

Expansion of total revenues continued up to stage VI (the rise was more than 28 per cent) and declined only slightly to stage VII. This was due to the time lag in the payment of tax liabilities, especially in the corporate tax area. The sharp drop in receipts took place between VII and VIII with a further small drop to stage IX. In all, receipts declined 10.5 per cent between stages VI and IX. As in earlier peacetime cycles, there was smaller relative variation in the expenditure cycle than in the receipts cycle. Thus, the surplus or deficit cycle derives its pattern of movement largely from the cyclical variation of revenues.

Income tax, customs, and miscellaneous internal revenues climbed at very similar rates throughout the expansion. The similarity disappeared during the contraction; yet, taking the cycles as a whole, all three major components of federal receipts conformed closely to business conditions and to each other (Chart 21).

Income tax receipts, which amounted to 80 per cent of all revenues during the 1954-1958 cycle, are largely responsible for the patterns displayed by total receipts and by the surplus-deficit series. The pay-as-you-go basis for the payment of income taxes, introduced in 1943, made the revenue system more responsive to economic conditions than it had been since this tax was first introduced. Tax receipts rose to a peak at stage VII, in mid-contraction, and then fell sharply. The amplitude of rise and fall was considerably greater than that of gross national product, just as in the 1921-1938 period. Since changes in tax rates after 1954 were relatively slight, the cyclical swing in tax receipts was due primarily to variations in the levels of personal income and of corporate profits.

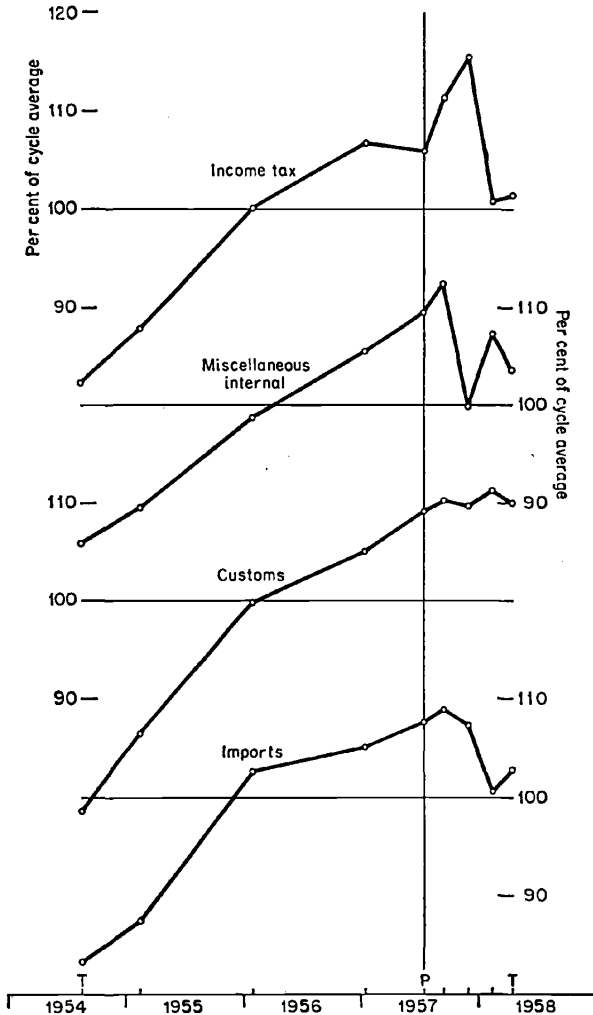
A revision in the internal revenue laws passed in 1954 provided for the application of the "pay-as-you-go" feature to the corporation income tax laws. The transition was introduced in graduated fashion with only a 10 per cent payment of the estimated tax made on or before December 31, 1956. This was increased so that in 1959 the payment to be made before the end of the year amounted to 50 per cent of the estimated tax. It is difficult to evaluate the effects of this new method of corporate tax payments because of its recency and its relatively light impact on the revenue system in the period covered by this study. Undoubtedly, it will make the income tax receipts and total revenues more sensitive to swings in the business cycle.

The 1954-1958 Cycle

Miscellaneous internal revenues conformed rather closely to the 1954-1958 cycle. In fact, in each of the peacetime cycles since 1933, these revenues have conformed more closely than in the earlier peacetime cycles. They have consistently shown a tendency to lag at cyclical peaks, reaching their highest

CHART 21

United States Imports and Selected Federal Receipts, Reference Cycle Patterns, 1954-1958



Source: Customs, miscellaneous internal revenue, and income tax from Table A-5, Sections D, E, and F, respectively; imports from Table A-7.

The 1954-1958 Cycle

cyclical level at stage VI rather than stage V (cf. Chart 17). In the earlier peacetime cycles, the dominant upward trend of these revenues usually prevented any sizeable contraction; whereas in recent cycles, while there is still a tendency to lag at the peak, revenues have tended to decline during the contraction phase.

Customs revenues since World War II have amounted to about 1 per cent of total revenues; consequently, they have had a negligible effect in the determination of the cyclical patterns of government finance. During 1954-1958, they conformed fairly closely to the patterns displayed by the other revenue components and by the total as well. While the pattern is one of positive conformity, the contraction phase of the cycle was characterized by a leveling off of receipts rather than by the usual decline. This happened despite the sharp decline in imports, apparently because imports of manufactured goods, which bear relatively heavy duties, were maintained during the contraction phase.