97 97

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-FIFTH CONGRESS

FIRST SESSION

PURSUANT TO

Sec. 5 (a) of Public Law 304

79TH CONGRESS

JUNE 3, 4, 5, 6, 7, 13, AND 14, 1957

Printed for the use of the Joint Economic Committee

UNITED STATES
GOVERNMENT PRINTING OFFICE
93528 WASHINGTON : 1957

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
JOHN SPARKMAN, Alabama, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	PAUL H. DOUGLAS, Illinois
WILBUR D. MILLS, Arkansas	J. W. FULBRIGHT, Arkansas
AUGUSTINE B. KELLEY, Pennsylvania	JOSEPH C. O'MAHONEY, Wyoming
HENRY O. TALLE, Iowa	RALPH E. FLANDERS, Vermont
THOMAS B. CURTIS, Missouri	ARTHUR V. WATKINS, Utah
CLARENCE E. KILBURN, New York	BARRY GOLDWATER, Arizona

JOHN W. LEHMAN, *Acting Executive Director*

SUBCOMMITTEE ON FISCAL POLICY

WILBUR D. MILLS, Arkansas, *Chairman*

THOMAS B. CURTIS, Missouri	PAUL H. DOUGLAS, Illinois
	JOSEPH C. O'MAHONEY, Wyoming
	BARRY GOLDWATER, Arizona

NORMAN B. TURE, *Economist*

CONTENTS

PANEL DISCUSSIONS AND INDIVIDUAL WITNESSES IN ORDER OF APPEARANCE

STATEMENTS

ADDITIONAL INFORMATION

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

MONDAY, JUNE 3, 1957

Congress of the United States,
Subcommittee on Fiscal Policy of the
Joint Economic Committee,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to call, in room G-16, the Capitol, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Senators Douglas and O'Mahoney, and Representative Mills (chairman of the subcommittee).

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy, and John W. Lehman, acting executive director.

Representative Mills. The subcomittee will come to order.

On behalf of the Subcommittee on Fiscal Policy I want to welcome you to these hearings on fiscal policy implications of the economic outlook and budget developments.

As we all know, recent budgetary developments in the Congress and in the administration have focused attention on the prospects for tax reduction in the near future. It is, I believe, the feeling of all the members of this subcommittee that inadequate attention may have been paid to the economic outlook and to the difference between reductions in the President's budget and reductions in actual spending by the Government in fiscal 1958. Careful appraisal of these factors, however, is needed if sound decisions about tax changes are to be made. The purpose of these hearings is to bring into clearer perspective the economic considerations which must go into responsible fiscal policy.

The Ways and Means Committee in the House of Representatives, of course, initiates tax legislation. The Joint Economic Committee, under the Employment Act of 1946, has a continuing responsibility to follow economic developments and to advise Congress on adjustments in public policies which may be desirable for economic growth and stability. This subcommittee's inquiry, therefore, is directed toward the broad outlines of fiscal action appropriate to current and foreseeable economic and budgetary conditions. It is our hope that these hearings will perform a real service to the Congress, and to the public as a whole.

The plan for these hearings has been detailed in public releases by the subcomittee. Today we are to hear from a panel of distinguished economists on the economic outlook for the coming months. In this connection, I ask unanimous consent to include in the record at the close of today's hearing a memorandum prepared by the Joint

Economic Committee staff on the economic situation and outlook. This memorandum was released to the public on May 23, and I believe that all of those invited to participate in these hearings have received copies.

We will hear the opening statement of each witness before proceeding with questions.

Our first witness is Mr. Robert Ulin, department of economics, McGraw-Hill Publishing Co.

Mr. Ulin, we are happy to have you with us, and you are recognized.

STATEMENT OF ROBERT P. ULIN, DEPARTMENT OF ECONOMICS, McGRAW-HILL PUBLISHING CO.

Mr. ULIN. Mr. Chairman, I am grateful for the opportunity to appear before this committee and contribute to this panel discussion on the economic outlook. My contribution will be on the outlook for private investment, since on this subject I am able to report some important facts about our prospects for 1957 and 1958. The McGraw-Hill department of economics, with which I am associated, recently conducted a survey—covering a very wide sample of American industry—of business plans for new plants and equipment in 1957, and 1958 to 1960. So far as I know, this is the only data now available on plans beyond 1957. I will summarize in my opening statement the main findings of our survey and the main conclusions I draw from them.

Now, as to our findings: Investment will rise in 1957. Our recent survey indicates that investment in new plant and equipment will be about 12 percent higher than in 1956. We have not surveyed intentions on a quarterly basis, but it seems likely that to achieve present goals investment will increase gradually all during 1957.

Investment will be stable in 1958. Our survey shows that business already plans to invest almost as much in 1958 as in 1957. More projects will be added as time goes on. So even if some companies invest less than now planned, our overall level will be close to 1957—which is high by any standard. With so much investment already scheduled, chances of a serious decline next year seem quite remote.

One important reason for continued high investment in new plant and equipment is the increase in spending on research and development. We find that business is spending 20 percent more on research in 1957 than in 1956, to develop a wide range of new products and new processes. These new developments will account for a significant share of the new investment planned for 1957 and 1958—and will offer additional opportunities for investment in the years ahead.

Another important reason for large outlays on plant and equipment has been to increase manufacturing capacity. If present plans work out, our total manufacturing capacity will increase 6 percent in 1957. But in 1958 and subsequent years, most companies plan to add less capacity and spend more on new products and new processes.

Now, what conclusions can we draw from these facts? I suggest the following:

1. A high level of investment will be a support to the economy in 1957 and in 1958. But we cannot expect much stimulus, because

changes will be small from now on. Plans for capital expenditures in 1958 are close to 1957, but they don't indicate much rise. And this picture of a relatively stable trend is supported by data we collect on new orders for machinery and new contracts for construction. In recent months, there has been little change in our index of new orders for machinery and some decline in our index of contracts for industrial construction, which is based on data reported by our magazine Engineering News-Record. Backlogs of planned work are still large but no longer increasing.

Now, my second point I think is important. The large capital investment programs of 1956 and 1957 are providing us with substantial protection against future shortages of goods, and against cost increases that might result from such shortages.

At the end of 1956, manufacturing companies on the average were operating at 96 percent of capacity; so they had a 14 percent reserve. I estimate this may reach 17 or 18 percent in 1957. Now, this does not mean we are badly overexpanded; some reserve capacity is desirable to anticipate growth and to meet defense or other emergencies. But it does mean that our productive capacity is much more ample than it was a year ago or 2 years ago—when inflation began to pick up steam.

In general, therefore, the outlook for investment in new plant and equipment is such as to support a high and rising level of business, but it is not such as to support, or at least not contribute to, renewed inflation. I believe this statement may be applied to our total investment picture, which also includes housing and inventories.

Now, will changes in Federal appropriations or spending for fiscal 1958 change this picture for private investment? In the field of plant and equipment, with which I am most familiar, the answer is: Probably not.

As I have indicated, most plans for 1957 and early 1958 are already made. Much equipment is already under contract. So the level of this year's private investment may not be much affected by this year's decisions on Federal spending.

Over the longer run, actions taken by our Federal Government are bound to affect private investment. For example, any reduction in Federal spending would permit transfer of funds to private investment projects. And it is my personal belief that such funds could be profitably employed.

The reason is that there are so many new opportunities, new products, and new processes coming out of the increase in industrial research, and these new products will need new facilities, even if we have plenty of capacity to make old products. It is difficult to predict how much more investment might take place, or how soon. But I would be remiss if I did not point out, in conclusion, that there do exist private investment opportunities for any funds that are released by a substantial reduction in Government spending.

Mr. Chairman, that concludes my opening remarks. I have a longer statement, for the record, which includes considerably more detail.

Representative MILLS. Without objection, your entire statement will be inserted in the record at this point.

(The statement referred to is as follows:)

THE OUTLOOK FOR PRIVATE INVESTMENT IN 1957-58, STATEMENT OF ROBERT P. ULIN, DEPARTMENT OF ECONOMICS, MCGRAW-HILL PUBLISHING CO.

I am grateful for the opportunity to appear before this committee and contribute to this panel discussion on the economic outlook. My contribution will be chiefly on the outlook for private investment in plant and equipment, since on this subject I am able to report some important facts about the prospects for 1957 and 1958. The McGraw-Hill department of economics, with which I am associated, recently conducted a survey—covering a very wide sample of American industry—of business plans for new plants and equipment in 1957, and in 1958 to 1960. So far as I know, this is the only data now available on plans beyond 1957. Our time is brief, so I will summarize in this opening statement the main findings of our survey and the main conclusions I draw from them.

The main findings on the investment outlook are these:

1. Investment will rise in 1957. Our recent survey indicates that total business investment in new plant and equipment will be about 12 percent higher than in 1956. We have not surveyed intentions on a quarterly basis. But it seems probable that, to achieve present goals, investment will have to increase gradually all during this calendar year.

2. Investment will be stable in 1958. Our survey shows that business already plans to invest almost as much (within 6 percent) in 1958 as in 1957. Additional projects are sure to be added as the year approaches. So even if some companies invest less than now planned, the overall level will be close to 1957—which is high by any standard. With so much new investment already scheduled, the chances of a serious decline next year seem quite remote.

3. One important reason for continued high investment in new plant and equipment is the increase in spending on research and development. We find that business is spending 20 percent more on research in 1957 than in 1956, to develop a wide range of new products and new processes. These new developments will account for a significant share of the new investment planned for 1957 and 1958, and will offer additional opportunities for investment in the years ahead.

4. Another important reason for large outlays on plant and equipment has been to increase manufacturing capacity. If present plans are carried out, our total manufacturing capacity will increase 6 percent in 1957. But in 1958 and subsequent years most companies plan to add less capacity and spend more on new products and new processes.

What conclusions can we draw from these facts? I suggest the following:

1. A high level of investment will be a support to the economy in 1957 and 1958. However, we cannot look for much additional stimulus, because changes will be small from now on. Plans for capital expenditures in 1958 are close to 1957, but they do not indicate any further rise. This picture of a relatively stable trend in capital investment is supported by data we collect on new orders for industrial machinery and new contracts for industrial construction. In recent months, there has been little change in the McGraw-Hill index of new orders for machinery and some decline in our index of contracts awarded for industrial construction (which is based on data reported by our magazine Engineering News-Record). Backlogs of planned work are still large but are no longer increasing.

2. The large capital investment programs of 1956 and 1957 are providing us with substantial protection against future shortages of goods, and against cost increases that might result from such shortages. Manufacturing industry has now achieved sufficient reserve producing capacity to meet a considerable upswing in demands for goods, without the rise in costs that generally occurs when plants are forced to work near capacity.

At the end of 1956, manufacturing companies—on the average—were operating at 86 percent of capacity; i. e. they had a 14 percent reserve. Additional capacity to be installed in 1957 will increase this reserve to perhaps 17 percent or 18 percent. This does not mean that industry is badly overexpanded; some reserve of capacity is desirable to anticipate future growth and to meet defense or other emergencies. But it does mean that our productive capacity is much more ample than it was a year ago or 2 years ago—when inflation began to pick up steam.

In its early stages, a large capital investment program may accentuate shortages in the economy by absorbing skilled labor and scarce materials.

But in the later stage—what might be called the payoff stage—which we have now reached, the requirement for labor and materials levels off. And we begin to get results from the investment. The result is new capacity that can substantially increase our supply of goods. So at this point, the effect of a high and stable level of investment is to reduce inflationary pressures.

In general therefore, the outlook for investment in new plant and equipment is such as to support a high and moderately rising level of business activity during the next 12 months—but not such as to support, or at least not to contribute to, renewed inflation. We have not made detailed studies of the other types of fixed investment—housing and inventories—which I presume will be covered by other competient experts who are with us today. I will simply say that, in general, we do not expect marked changes in these sectors either. Since homebuilding has been relatively depressed, and since there was no addition to business inventories in the first quarter, it seems logical that some increase may take place in both types of investment. But very large increases do not appear likely, based on the general economic situation or on such reports as we have received from business firms with whom we are in contact.

To sum up, in statistical terms, our projections call for gross private domestic investment (which is a total figure for plant and equipment, housing and inventories) to increase from an annual rate of $63 billion to $64 billion in the first half of 1957 to $67 billion to $68 billion in the first half of 1958. This will provide a moderate additional demand for investment goods, but it is a demand that can easily be met by the new productive capacity of the capital goods industries. Also, it is reasonable in relation to a normal growth trend for the overall economy.

Would changes in Federal appropriations or spending for fiscal 1958 change this picture for private investment? In the field of new plant and equipment, with which I am most familiar, the answer is: "Probably not." As I have indicated previously, most of the plans for 1957 and early 1958 are already made. A substantial amount of equipment and construction is already under contract. In many cases, a year or more is required to make the plans, let the contracts, and accomplish the construction of complex industrial projects. Therefore, the levels of this year's private investment are not likely to be affected in a substantial way by this year's decisions on Federal spending.

Over the longer run, actions taken by the Federal Government are bound to have significant effects on private investment. For example, any reduction in Federal spending would permit transfer of funds to investment projects, and it is my personal belief that such funds could be profitably employed. The reason is that there are so many new opportunities—new products and new processes—coming out of the increased effort in industrial research. These new products will require new manufacturing facilities, even though we have plenty of capacity to make old products. It is difficult to predict how much additional investment might take place, or how soon. But I would be remiss if I did not point out, in conclusion, that there do exist private investment opportunities for any funds that are released by a substantial reduction in Government spending.

I would now like to turn to a more detailed discussion of the points raised in this summary statement:

The rise in investment in 1957: Almost every major industry is increasing its investment in new plants and equipment this year. The amounts vary from industry to industry. For example, the capital expenditures of electric and gas utilities will increase more than for most manufacturing industries. The exact amounts of increase also vary as between those reported in the McGraw-Hill Survey and those reported by the Department of Commerce, Securities and Exchange Commission. It is especially worth noting that the latter survey reported a sharp decline in the investment plans of small commercial firms (which are not surveyed by McGraw-Hill), resulting in a smaller reported increase in total business investment.

However, there is no disagreement between sources on these main points: (*a*) that investment will be substantially higher in 1957 than in 1956, (*b*) that the largest increases will be in public utilities and certain basic manufacturing industries, (*c*) that investment in light manufacturing will not increase as much, and (*d*) that the only area not showing a significant increase will be commercial business, i. e., trade, finance, and services.

Increase in investment (1956-57), as shown by two recent surveys of plans for new plants and equipment:

[Percent]

	McGraw-Hill	Commerce, Securities and Exchange Commission
Electric and gas utilities	+22	+24
Transportation (except railroads) and communications	+17	(1)
Railroads	+11	+19
Manufacturing:		
Primary metals	+49	+47
Chemicals	+31	+24
All other manufacturing	+4	+3
Commercial	[2]+2	−6

[1] Not comparable.
[2] Large chainstores, mail order and department stores, banks and insurance companies. Does not include small stores and service establishments.

The largest programs in 1957 are those that involve a substantial buildup of capacity in the basic industries. It is well known that in recent years the expansion in manufacturing generally has put a strain on our resources of fuel, power, and basic raw materials. So it is in these fields that investment now is increasing the most. During 1957 the steel industry will increase its capacity by 6 million ingot tons, the electric power industry will add 9.1 million kilowatts of new generating capacity, and capacity to produce chemicals will rise by 9 percent. We are adding a large amount of new aluminum capacity and substantial new facilities for petroleum products. The transportation industries are adding more capacity all around—ships, barges, pipelines, freight cars, and aircraft. The overall result of these varied programs will be to relieve a number of bottlenecks in the economy.

On the other hand, capital expenditures are no longer increasing rapidly in the lighter manufacturing industries—the ones that fabricate raw materials into consumer goods. The automobile industry is spending less in 1957 than in 1956; the food and textile industries, very little more. In all these industries, this year's increases in capacity will be nominal. The same comment applies to most lines of metalworking, although in some of the heavy machinery industries expansion is continuing to meet special needs.

Thus, although 1957 will be a record year for business capital investment, this is by no means a wild sort of boom in which companies are expanding without regard to basic demand. It seems rather to be a process of orderly growth that is tied to long-term objectives for the various industries. Where capacity is already adequate—as it is for most lines of consumer goods—investment is leveling off. The really large investments are being made where they are most needed—in the fields of raw materials, power, and transportation.

PROSPECTS FOR STABILITY IN 1958

The continuing expansion of these basic industries provides the foundation for a high level of capital investment in 1958. The programs of the steel, aluminum, power, and transportation industries are not limited to 1957. In fact it will be impossible to complete these programs, which involve very long lead-time equipment, before 1958 at the earliest. Some of the orders now outstanding for ships, commercial aircraft, power generating and communications equipment cannot be completed until 1959. The same comment applies to exploration programs for oil and other minerals. There is, therefore, a substantial volume of investment already on a definite schedule for next year. Plans are already near the 1957 level in the fuel, power, and transportation industries (except railroads). Manufacturers' plans are still much less definite, as indicated by the table below:

Plans for capital investment

[Millions of dollars]

Industry	1956 actual [1]	1957 planned	Preliminary plans	
			1958 investment	1957-58 percent change
All manufacturing	$12,787	$14,542	$12,390	−15
Petroleum and mining	5,974	6,640	6,793	+2
Railroads	1,231	1,366	1,188	−13
Other transportation and communications	4,229	4,963	5,060	+2
Electric and gas utilities [2]	4,895	5,991	5,880	−2
Commercial [3]	8,236	8,401	8,065	−4
All business [4]	36,641	40,979	38,397	−6

[1] U. S. Department of Commerce, Securities and Exchange Commission. McGraw-Hill Department of Economics. Plans for 1957-58: McGraw-Hill survey April 1957.
[2] Gas utilities based on survey by American Gas Association for 1957-60.
[3] Large chainstores mail-order and department stores banks and insurance companies.
[4] Petroleum refining included under both manufacturing and petroleum industry counted only once in the total.

It must be emphasized that these are preliminary plans. In manufacturing especially, many new projects will be added when budgets are considered next fall. So it is reasonable to assume that the overall level of investment in 1958 will be very close to 1957. It might even exceed 1957 if circumstances were favorable.

THE GROWING IMPORTANCE OF RESEARCH

Much of the investment that will take place in 1957 and subsequent years will result from the new discoveries of industrial research. We are just beginning to see significant results, in the investment field, from the rapid growth of research outlays in the years 1950–56, and especially since 1953. There is generally a lag of 4 to 7 years between the beginning of a research program and the development of a commercial product. Another 2 or 3 years may pass before output of the product reaches a quantity that calls for large new plant investment. But as the result of research and development in 1950–56, we can now expect an increasing flow of new projects for investment in 1957–60. It seems clear from plans reported in our latest survey that more new products will reach the market in 1957–60, and more new processes will enter industrial technology, than in any previous 4-year period.

Expenditures on research and development reached $6.1 billion in 1956—up sharply from the $4.8 billion spent in 1955, and well above estimates for 1956 reported only a year ago. This increase in research spending of 28 percent is perhaps the most impressive single figure reported in the current survey. Plans for 1957 indicate another 20 percent increase this year—to $7.3 billion. Industry already has plans to spend $9.3 billion on research by 1960—a preliminary estimate that will be far exceeded if the present rate of increase in research spending continues.

There is already a sharp increase in the number of companies that are making significant capital expenditures to bring out new products. In manufacturing as a whole, 32 percent of all firms expect to make such expenditures in 1957, compared to 28 percent in 1956. Some of the individual industries show much sharper increases. In steel, for example, the number of companies planning capital expenditures to make new products is up from 6 percent of all firms in 1956 to 21 percent in 1957. In nonferrous metals, there is an increase from 25 percent of the companies to 42 percent. If capital expenditures to make new products follow the trend of expenditures on research, it seems possible that nearly half of all manufacturing firms will be investing for this purpose by 1960.

These figures demonstrate that many companies find new opportunities for investment arising from their research efforts. How much they will actually invest in 1958, or any other year, depends on the availability of funds, and on rates of profit at the time. But there is certainly no lack of new ideas—new frontiers so to speak—for investment. Although we do not have the great needs for capacity that existed a few years ago, we do have new outlets in the form of plant modernization and new product development. Over the long run, these new outlets are likely to absorb a substantial increase in the amount of funds available for private investment. In fact, the capital investment required to exploit fully our scientific and technical progress may eventually exceed the investment made to raise capacity in the early postwar years.

THE GROWTH OF MANUFACTURING CAPACITY

The technical revolution that is in progress will mean a great increase in industrial modernization and in financial outlays required for that purpose. Therefore it is fortunate that most industries are no longer pressing as hard to add new capacity. Throughout the postwar period, manufacturing companies particularly have been struggling to catch up with their capacity needs, and to achieve some reserve against future upswings in demand. They have been caught short—by the immediate postwar demand, by Korea and by the consumer goods boom in 1955. But in the past year, most companies have achieved a better capacity reserve.

At the end of 1956, manufacturing companies were operating—on the average—at 86 percent of capacity, leaving a 14 percent reserve margin. By the end of 1957 this reserve will be even larger. Thus industry is in shape to meet any near-term upswing in consumer demand without large, new expansion programs. In fact, the manufacturing capacity now in place (or under construction) may be enough to meet most of our normal growth requirements as far ahead as 1960. Modernization and replacement programs will yield some capacity increase each year (perhaps 2–3 percent) by making present facilities more efficient. But industry's plans for 1958–60, as reported in our recent survey, do not call for as much emphasis on completely new facilities as in recent years.

In 1957, we are told, about 52 cents of every investment dollar is going into new expansion projects. But in 1958–60, present plans call for only 47 cents of the investment dollar to go into expansion (as an average for all manufacturing). Most of the investment in these future years is intended for modernization, replacement and the introduction of new products. With adequate capacity in place, industry will be able to devote more funds to upgrading its products and processes.

PROTECTION FOR THE ECONOMY

It is equally important to note that a substantial reserve of manufacturing capacity provides our economy with protection against shortages and inflation—for better protection than we have had at any time since World War II. There is no longer any reason for scare buying of consumer goods, and very little reason to anticipate shortages of industrial materials or equipment. Moreover, the new efficient capacity that has been added recently will permit manufacturers to meet additional demand for goods—in most cases without resort to overtime, extra shifts, or other high-cost expedients. We are moving from a bottleneck economy, with an emphasis on expansion, to a more relaxed economy in which the emphasis will be on new products and better processes as the reasons for investment.

In this type of economy, investment will continue to provide stimulus for general economic growth. But its greater contribution will be to lay the basis for rising living standards, by providing new and better products at reasonable cost. I expect this improvement to proceed rapidly between now and 1960, and it may be even more rapid if substantial investment funds are released by a reduction in Government spending.

Representative MILLS. Our next panelist is Mr. William W. Tongue, economist, Jewel Tea Co., Inc.

Mr. Tongue, you are recognized.

STATEMENT OF WILLIAM W. TONGUE, ECONOMIST, JEWEL TEA CO., INC., MELROSE PARK, ILL.

Mr. TONGUE. Mr. Chairman and gentlemen, the Joint Economic Committee staff's appraisal of the economic situation and outlook, as outlined in their memorandum of May 23, 1957, seems eminently sound. A gross national product of $435 billion for 1957 implies personal disposable income in excess of $300 billion, which would support consumer spending of more than $280 billion. These figures represent increases of approximately 5½ percent from 1956 and nearly 2 percent from rates in the first quarter of 1957. Price increases will deflate these gains in real terms, but it is clear that if they materialize 1957 will chalk up new records in production and employment.

STRENGTHS IN THE PRIVATE ECONOMY

The specific numbers one forecasts help to outline the general characteristics of the economic picture one foresees. Of equal significance is the confidence one has that the picture will actually develop as indicated—for forecasting is not today an exact science and economists' projections are always made with the knowledge that they may be upset by unexpected developments. I believe we can have a high degree of confidence that so far as the private economy is concerned the present level of activity is solidly based and any surprises upsetting the forecast are more likely to be on the upside than on the downside.

We have already heard about the outlook for capital expenditures, and I will say no more about that.

Second, a part of final demand is currently being met from the drawing down of business inventories. This "inventory adjustment" is so far occurring without any weakening of final demand and can be expected to be completed in short order. While a strong shift of business sentiment in favor of inventory accumulation does not seem a near-term probability, it does appear that there will be little further depressing effect on production rates from inventory cutting.

Finally, we turn to the most important, and frequently the most ignored, group shaping the business picture—the consumers of America, whose purchases of goods and services, including housing—and I have included housing here throughout, because it is consumer-oriented and consumer-inspired—total more than two-thirds of the gross national product and 85 percent of the privately produced gross national product. Examination of consumers' behavior in the recent past is reassuring as to their probable contribution to future business levels.

Consumers, ever elert to opportunities to improve their standard of living, were quick to react to the substantial easing of money rates and borrowing terms which occurred in 1954 and continued into 1955. Consumer spending on goods and services, including housing, rose from an annual rate of $242 billion in the fourth quarter of 1953 to a rate of $275 billion in the third quarter of 1955. The rise of $33 billion compared with a total increase of $39 billion in gross national product, and exceeded the rise in disposable personal income by $10 billion or 44 percent. Consumer spending, including housing, rose from 97 percent of disposable income in 1953 to over 100 percent in the third quarter of 1955. Such is the strength of the desire of consumers to better their level of living; and such is the power of easy money reinforced by tax reductions.

Consumers showed equal good sense in 1956 by reducing their rate of borrowing as interest rates rose and credit terms tightened. While total consumer spending continued to rise gradually through 1956 and thus far into 1957, it has been brought into a more normal relationship to income. By the second quarter of 1956, total spending, including housing, had dropped down to 98 percent of disposable income. It has continued to hold at approximately this ratio for the past year, despite widely-publicized warnings ranging from predictions of runaway inflation to dire depression, sometimes in the same statement. This stability of consumer behavior speaks volumes for the solid good sense of the American people, and the confidence they have in our future. It also gives us ground for believing that consumers have adjusted their spending to current conditions and are likely to be a support to the economy for the visible future.

In summary, the three major determinants of private business activity—consumer expenditures, business spending on plant and equipment, and changes in inventory—seem very unlikely to exert a downward push on business activity this year, and most probably will have an expansive influence.

A fourth factor, net foreign investment, may well moderate, but should not offset entirely, the expansion expected from the combined forces of the three factors summarized above.

This view of the business outlook, which is consistent with that of the committee staff, is predicated on the assumption of rising Government expenditures, a rise which seems assured at the State and local level.

We now turn to the question asked in the schedule of hearings:

> What would be the impact of substantial reductions in Federal appropriations and spending for fiscal 1958 on the level of economic activity during 1957–58?

This much to be desired development, for which we all pray would permit the transfer of productive resources from supplying goods and services for the Federal Government to supplying goods and services for the private economy and possibly for State and local government activities. This would make possible the raising of the standard of living of the American people, enabling them to enjoy some of the fruits of our rising national production which have been absorbed by rising Federal budgets, and make additional funds available to the capital markets for productive investment, including investment in houses and other durable consumers' goods. All of those would add to the economic capacity and strength of the American people.

This is the end product that a substantial reduction in Federal spending makes possible. To realize this, however, requires careful and responsible public action, such as suggested below; for a reduction in Federal spending, taken by itself, would depress economic activity. And the depressing effect would doubtless be greater than the decline in Federal expenditures alone.

To prevent a downward spiral and to facilitate the reemployment of people and physical resources freed by declining production for the Federal Government, a positive public policy would be required. Part of such a policy might well include an easing of the money markets by Federal Reserve action. However, easy money should not be the sole weapon of public policy if more than a token reduction in Federal expenditures is contemplated. There is no clear presumption that monetary policy would be sufficient to offset a substantial reduction in Federal spending; but there is ample evidence, as indicated in the discussion of our 1954–55 experience, that easy money, coupled with tax reduction, would provide a strong stimulus to the economy, sufficient to absorb people released from Government activity into productive private employment.

The easy money policy would make the funds available in the money markets, while the tax reduction would give people and business firms added income which could in part be spent directly on consumption and in part could be used as the basis for added borrowing. The added borrowing would be used by consumers and business to purchase physical assets, such as the houses, machinery, and other durable goods which constitute the real wealth of the country. The strongest stimulus to such action would come from an across-the-board reduction in taxes rather than one concentrated in any one group.

With respect to the timing of tax reduction, it seems clear that this should become effective when the decline in Federal expenditures becomes a fact. However, an announcement that Federal spending will decline in the future would have an immediate depressing effect on raw material purchases, plant and equipment planning, and possibly on employment, for those firms that would be affected by the spending cutback. To offset this, it would be helpful to have an announced expression of intent to reduce taxes when spending is cut—or, better still, an actual bill cutting taxes might be passed, to become effective with the decline in spending.

Our present tight money markets reflect a shortage of savings relative to demand to use these savings by business for plant and equipment, by State and local governments for schools and other local public works, and by consumers for houses and other durable goods. Consequently, while a substantial part of any saving in Federal expenditures should undoubtedly be restored to the people through tax reduction, a part should also be devoted to reducing the Federal debt, thereby adding to the availability of funds in the capital markets. It would be the responsibility of the monetary authorities to see that these funds are channeled into productive use. This course would both add to the spendable income of consumers and help to build up the economic wealth and strength of our country.

Mr. Chairman, that concludes my statement.

Representative MILLS. Our next panelist is Prof. Irwin Friend of the University of Pennsylvania.

Professor Friend, you are recognized.

STATEMENT OF IRWIN FRIEND, PROFESSOR, WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

Mr. FRIEND. There are two aspects of the current economic situation which are basic to an appraisal of the overall economic outlook over the next 6 to 12 months and to the implications of proposed changes in Government expenditures or taxes. First, the level of our national income is at a record high following the greatest and longest period of prosperity in our history. Second, various economic indicators have in recent months pointed to hesitation or loss of momentum in the rate of advance in business activity.

Some of the major sectors in the economy have been showing signs of weakness, residential construction for over a year and in the past few months inventory investment and perhaps auto purchases as well Even business plant and equipment outlays, one of the mainstays of the post World War II boom, have been leveling off. Moreover, a high proportion of the economic series which are regarded by the National Bureau of Economic Research as leading; (i. e., turning earlier than) overall business activity have been declining for varying periods of time. New orders, private construction contracts and permits—residential and nonresidential—average hours worked, new business incorporations, and wholesale prices of basic commodities have all tended downward while business failures have increased. Of the key "lead" series employed by the National Bureau, only stock prices have been at all buoyant in recent months. While I do not happen to believe in the predictive value of many of these so-called lead series—which indeed could have been interpreted as implying recessionary tendencies for some time—the indication they give of somewhat less zip in the economy cannot be ignored.

The money markets also have been showing signs of extreme tightness frequently associated with advanced stages of business boom. The very rapid rise in interest rates over the past year, however, may have reflected not only such economic considerations as higher investment demand and lower liquidity but also the psychological setting induced by Federal Reserve and Treasury policy.

The most important sources of buoyancy for the economy as a whole in recent months have been the increases in Federal and State and local government purchases of goods and services, a more rapid increase in consumption than in personal disposable income (i. e., a rise in individuals' propensity to consume) and a rise in net foreign investment. Of these the upward trend in Government expenditures is the most significant, and the most likely source of continued support for the economy over the next couple of years—at least under the administration's budget proposals. In a sense, rising Government expenditures—particularly Federal—may be regarded as taking over for this year and perhaps next the role of rising business investment in plant and equipment last year and rising investment in inventories and residential construction the year before as the most dynamic element of strength in the business situation.

Looking ahead for the next 6 to 12 months, there does not seem to be much reason for anticipating any significant change in the overall economic situation. The administration's budget for fiscal 1958 appears to imply a billion dollar increase a quarter in the rate of Federal spending, and State and local government expenditures may increase by another half billion quarterly. Recent surveys of the outlook for investment in plant and equipment over the next year or so—including surveys of business plans to invest, actual capital appropriations by business, and expected sales by capital goods producers—suggest little change in the rate of expenditures on plant and equipment during this period. There is less evidence available for appraising the likely trend in residential construction, business inventories, net foreign investment, and individuals' propensity to consume, but there is no strong basis for expecting much change from the current situation in any of these sectors. Consequently, with the indicated rise in Government expenditures and with no evidence of significant changes elsewhere in the economy, it seems likely that the national income for the next year will be fully as high and probably somewhat higher than it is currently. On the other hand, there is no indication of aggravated inflationary pressures, with a rise in the labor force and in productivity offsetting a long part of the effect of increased Government expenditures.

Turning finally to the implications of proposed changes in the Federal budget, a reduction of $1 billion or $2 billion in presently budgeted expenditures during fiscal 1958 is not likely to change the economic outlook to any important extent. A substantially larger reduction—say $5 billion or more—might give rise to significant deflationary pressures, and probably should be associated with some reduction in tax rates and with policies directed toward easing of current money market conditions. Unless economic conditions deteriorate appreciably, any reduction in tax rates should be small and calculated to leave a modest cash surplus at the current level of national income.

The implications for monetary and tax policy of proposed reductions in Federal expenditures merit further consideration. With private investment demand leveling off, even a moderate ($2 billion to $5 billion) reduction in Government outlays budgeted for fiscal 1958 might make the economic outlook sufficiently shaky to warrant easier money market conditions to stimulate investment. However, with a large volume of Treasury refinancing in prospect and the market for United States Government bonds already rather demoralized, it is not at all clear that without positive government action interest rates would fall. Under these circumstances, a moderate reduction in Federal expenditures at this time probably should be accompanied by Federal Reserve and Treasury action to ease the monetary stringency since such action is readily reversible and there would appear to be—under the circumstances I have discussed—more danger from deflationary than from inflationary pressures. (I might note parenthetically I do not believe that interest rates can be counted on to reach their optimal level in a "free market" regardless of economic conditions, or that reduction in interest cost to the Government is an irrelevant consideration in monetary policy.) Tax reduction—which is a more powerful antideflationary instrument than monetary policy and is not readily reversible—should probably be associated only with more substantial cutbacks in the Federal budget.

Thank you.

Representative MILLS. Our next panelist is Mr. Robinson Newcomb.

Mr. Newcomb, you are recognized.

STATEMENT OF ROBINSON NEWCOMB, WASHINGTON, D. C.

Mr. NEWCOMB. Mr. Chairman, as I understand my assignment this morning, it is, first, to present my judgment as to the prospects for housing under current economic and financial conditions and, second, to suggest what may be interfering with the growth that housing should enjoy under a high-employment, growing, stable, free-market economy; and third, to be brief.

The cessation of growth in the volume of homebuilding is not the result of lack of demand, measuring demand by what people are willing and able to buy.

Trends in demand can be discovered in many ways. One of the simplest, of course, is the measurement of vacancies, and the noting of trends in prices and rents being paid for existing properties. Such measurements indicate that there is a strong market for housing.

They do not measure just how strong the demand is. The following table suggests one method of measuring this demand.

(The table referred to is as follows:)

TABLE 1.—*Growth in number of households by income groups (in 1955 dollars) against market for houses*[1] *(using income average distribution for 5-year periods)*

Income group	1955: Growth in number of households[2]	1955: House building	1955: Ratio building to household growth	1957 or 1958: Growth in number of households[3]	1957 or 1958: Building market	1957 or 1958: Ratio building to household growth	Cost group
	Thousands			*Thousands*			
$4,000 to $5,000	220	234	106	0	100	----------	Under $10,000.
$5,000 to $7,500	620	592	95	550	550	100	$10,000 to $15,000.
$7,500 to $10,000	225	305	136	350	350	100	$15,000 to $20,000.
$10,000 and over	115	134	117	200	200	100	Over $20,000.
Total in groups gaining	1,180	1,265	107	1,100	1,200	109	
Loss in group losing	230	[4] 950		250	[4] 850		
	950	[5] 315		850	[5] 350		

[1] Source: See text.
[2] Distribution based on average rate of growth in each category from 1950–54.
[3] Distribution based on average rate of growth in each category from 1955–59.
[4] Net gain.
[5] Surplus.

Mr. NEWCOMB. The projections of the total number of households in this table for 1955–59 are based on detailed calculations of total household formation and are shown in a technical appendix, available for the record.

The data on the distribution of the growth in the number of households by income groups are based on Government material. The methods used here too are described in the technical appendix.

The left side of the table relates the volume of homebuilding, as indicated by the BLS, to income and household growth in 1955. The right side of the table suggests how many houses should be built just to take care of the demand resulting from the growth in the number of households by income groups, assuming no change in the proportion of incomes going to housing from 1955 to the present. If an arbitrary figure of 100,000 is used for the market for houses costing under $10,000—and this is probably too small—the market would absorb at least 1,200,000 houses now. That would permit the demolition, abandonment, or conversion of only about 350,000 houses—which is still a small number for our economy.

With the time at my disposal I obviously cannot describe this or other methods of calculating demand in detail, so I would refer to the technical material, and merely state here that it is my judgment that there is a sound market for at least 1,200,000 houses a year today.

Such a volume would not require increased amounts of credit—at least it would not require more than was used in 1955, but such a volume would require much better matching of the supply of new houses to the demand.

The market for housing is obviously competitive today with markets for other goods or services, such as automobiles, vacations, or rehabilitation of existing properties. Most, but not all, families are well enough housed now so they can choose between improving their housing, getting a bigger automobile, taking a more expensive trip, or improving the house in which they are currently living. When a salesman for automobiles, for travel, or for do-it-yourself remodeling materials can do better than the salesman for housing, or when the price of these competitive items is better than the price tag on a new house, some families who otherwise could be improving their housing standards may shift their expenditures elsewhere.

A large operator-builder with whom I spent some time recently complained strongly about the weakening of the market for his houses. An associate made a relatively scientific analysis of what the market was in the area where he was building, or who was buying his houses, and of the families to whom he was trying to sell. We discovered, for instance, that the families to whom he was making the appeal did not have the income for the houses he was building, and that while he was directing his sales efforts to homeowners whom he thought were prospects for upgrading, most of the sales were made to renters. By the time we were finished, we felt he had a market for the houses he was building but that the market was among a different type of families than those he was soliciting. There was a housing market too for the families he was soliciting, but the houses he was selling did not fit that market.

Careful market analysis and careful pricing are necessary if 1,200,000 houses are to be sold. Merely making funds available will not mean that this volume will be sold. But if the market analysis is properly made and the houses are efficiently designed, located, built, and priced, than the availability of credit adequate for 1,200,000 houses would, I believe, result in such a volume of construction.

It should be feasible to provide an adequate amount of funds without feeding inflation. The total money supply in the market as a whole will be greater in 1957 than it was in 1955. And a smaller net flow of credit to housing would be needed to provide 1,200,000 houses this year than was needed to provide the even larger volume of housing built in 1955. This is the case in part because repayments to mortgagees on the existing mortgage debt of over $100 billion are running appreciably higher than the repayments on the mortgage debt of something over $75 billion 2 years ago.

This point may be worth a moment for elaboration. The sale of 1,200,000 homes at the average price of $16,000 would yield an aggregate transaction value of $19.2 billion. At the same time, the market would require the sale of about 2,200,000 existing houses. At average transaction value of $11,000, this would mean $24.2 billion. These two categories together would result in a total transaction value of roughly $43.5 billion. These transactions in 1955 were probably in the neighborhood of $42 billion.

Assuming a total mortgage-to-transaction relationship for new housing of 57 percent (the same ratio reported for 1955), and of mortgages on old houses of 55 percent (as reported for 1955), and allowing for the mortgage writing on existing houses for purposes of improving the housing or for other reasons exclusive of sale, of $5 billion, the following mortgage writing would be required in 1957 to support 1,200,000 new 1- to 4-family house sales:

(The table referred to is as follows:)

Mortagage debt required for new: $10.9 billion (against $10.2 billion in 1955).

Mortgage debt required for old: $13.3 billion (against $13.3 billion in 1955).

Mortgage debt, 1- to 4-family houses, other purposes: $5 billion (against $5 billion in 1955).

Total new mortgage debt required: $29.2 billion (against $28.5 billion in 1955).

Total debt repaid in 1957: $17 billion, at 17 percent rate (against 21 percent rate and $16.1 billion in 1955).

Total increases in 1- to 4-family mortgage debt: $12.2 billion (against $12.4 billion in 1955, and $11.1 billion in 1956).

Mr. NEWCOMB. This 1,200,000 volume of new house sales would therefore require no more, and possibly less, net new credit than the $12.6 billion the economy provided when going at a somewhat lower level in 1955.

It would appear that there is enough credit extant to support such a volume if it could be tapped. The total flow of funds for investment purposes, including mortgages, has been increasing while the flow of funds on mortgages to 1- to 4-family homes has been decreasing, as shown in the following table:

(Table 2 is as follows:)

TABLE 2.—*Flow of investment funds, by use* [1]

[In billions of dollars]

	1955	1956	Anticipated 1957
Nonfinancial corporations	6.1	7.6	9.0
Other than 1-4 family mortgages	3.5	3.8	5.0
State and local debt	3.4	3.2	3.7
Total	13.0	14.6	17.7
1-4 family mortgages	12.4	11.1	9.0
Percent 1-4 family mortgage of other flow	95.4	76.0	50.8
Grand total	25.4	25.7	26.7

[1] Based on Bankers Trust Co. studies.

Mr. NEWCOMB. This table is based on the Investment Outlook reports of the Bankers Trust Co. The estimate of the flow of investment funds to nonfinancial organizations for 1957 is revised upwards from the $8.5 billion as originally published because the sale of new capital issues floated in the first 4 months of this year were nearly 50 percent greater than in the first 4 months of last year. This, and other facts, suggest that a small upward revision of the figure originally published may be in order.

The flow of credit to 1-4 family housing is dropping, while the total flow is rising, in part because of the fact that investment funds are now going more heavily to institutions which do not emphasize writing mortgages on 1-4 family residential properties. This is shown in the following table:

(Table 3 is as follows:)

TABLE 3.—*Flow of funds, by institutions* [1]

	1955	1956	1957
Life insurance companies	6.3	5.7	6.0
Corporation pension funds	2.0	2.2	2.3
State and local retirement funds	1.3	1.4	1.5
Time deposits, commercial banks [2]	1.7	2.1	3.2
Subtotal	11.3	11.4	13.
Mutual savings banks	1.9	1.9	1.5
Savings and loan associations	5.4	5.5	4.9
Subtotal	7.3	7.4	6.4
Ratio mutual savings banks and savings and loan to others	64.6	64.9	49.2
Grand total	18.6	18.8	19.4

[1] Based on Bankers Trust Co. studies.
[2] If the new interest rate permitted on FHA loans proves attractive enough, the projected increase in these time deposits for 1957 may support an increased volume of FHA insured lending.

Mr. NEWCOMB. This table suggests that the flow of funds to institutions not emphasizing home mortgages rose slightly in 1956 and may rise by $1.6 billion or 14 percent in 1957. The flow of funds to mutual savings banks and savings and loan associations rose by about $1 billion in 1956, and are forecast to drop by $1 billion or about 14 percent in 1957. While the flow of funds to these two institutions was 65 percent of the flow to the other institutions listed in 1956, it may be down to about 49 percent in 1957.

This may understate the seriousness of the decline because there was a greater possibility of shifting funds in 1956 than there may be in 1957. Mutual savings banks, for instance, could sell Governments more freely in 1956 than they probably can in 1957, so the decline in resources available for home-mortgage financing may be greater than suggested in this table. If, as the Bankers Trust Co. suggests, we have only $9 billion with which to finance net new home-mortgage writing in 1957, it may be difficult to finance much more than a million 1–4 family housing units this year. Should the available new mortgage money come to only $8 billion, it may be difficult to finance much over 900,000.

The data for the first 3 months of 1957 indicate the Bankers Trust Co. has not overdrawn the situation. The new flow of funds to savings and loan associations through March, for instance, was lower than it was a year ago, and actually 12 percent lower than it was in 1955. Money is not flowing as freely as formerly into mortgage markets.

In order to finance a million units with the possible $9 billion of net new mortgage money we may get this year; we would have to assume no increase in the purchase of existing houses with credit, or no increased mortgage borrowing to improve existing houses by families who find themselves unable to buy new.

It is possible also that we will not have $9 billion in new mortgage money because that figure assumes that about $17 billion will be paid off on existing mortgages. In view of the increase in interest rates and the difficulty of financing, it may be that mortgagors will not repay existing mortgages as rapidly this year as they did last. Should repayments drop to approximately 16 percent of the amount outstanding at the first of the year rather than 17 percent, the net flow of funds to the 1 to 4 family mortgage field might come to only $8 billion.

This might underwrite a new housing volume of approximately 900,000 rather than a million units.

It is obvious that under current conditions the total flow of investment funds will be greater this year than last year while the flow available for housing will be less. One of the main problems for the housing segment of the economy therefore is that of facilitating the flow of funds from institutions which are now getting more of personal savings than formerly back into the mortgage field.

This problem is aggravated by what has been called an "Iron Curtain" around some of our long-term credit institutions. The flow of savings over a period of time to savings and loan associations, for instance, may exactly match the need for mortgage funds from these institutions. But at times it may be in excess, and at other times it may be short of needs. The opportunities for savings and loan associations to secure funds are limited rather rigidly and almost entirely to flow of funds from individuals in the form of deposits, or the equivalent. When this flow is larger than these organizations can handle through their normal mortgage operations, the interest rate on mortgages may drop. When the flow of funds is not adequate, interest rates on mortgages can rise quite markedly. Nevertheless, savings and loan associations cannot easily go into the open market to get more funds to supply the mortgage needs.

In order to make it possible for money and credit to flow to the mortgage mart when it is needed, this "iron curtain" must be removed and interest rates must be as free as the rates in the remainder of the market.

Any control over interest rates should be a function of overall policy rather than control in one limited area only. When the attempt was made at the end of World War II to control the price of some building materials going into houses, it was discovered there was a tendency for these building materials to go elsewhere rather than into housing. If all prices had been controlled, it might have been possible to get an adequate flow of building materials to housing, but when it was less profitable to divert resources to housing than elsewhere, housing suffered. So, today, the effect of price control on certain types of mortgages has been to reduce the opportunity for individuals to choose between buying houses at higher interest rates and buying automobiles at higher interest rates, for instance.

Funds are flowing to institutions handling consumer credit, and the individual can buy automobiles if he chooses to pay the higher rate these institutions can command. He does not have that option with housing. So controlling interest in one segment of the economy only tends to mean not that individuals get more housing cheaper, but that they get fewer opportunities to buy houses.

I would like to raise one more point which I think is vital but which is not very often discussed. Many of our current financial institutions were created or altered after 1929. The frame of reference in which some of them were created emphasized the need for high liquidity as protection against loss. That was a frame of reference designed for a depression economy. The frame of reference in which we can have healthy growth with stability is quite different. Healthly growth requires both the flow of credit and of savings to and from the areas of shortage and surplus, and the most effective use of the savings flowing to each institution. The best use of savings does not mean that each institution should attempt to protect itself against depressions. Should a depression occur, a high liquidity would not be of much value. Overall steps would have to be taken to stop the depression. The existence of high liquidity ratios would not save the day.

If we provide for a healthy growth, the chances that a depression will come will be reduced. If all institutions have a high liquidity ratio, development of this ratio could slow down healthy growth and tend to create the condition against which high liquidity was designed to protect. It could then be argued that the need for high liquidity had been proven.

Governmental agencies have not been particularly helpful in facilitating the flow of funds between institutions. Neither has it been easy for them to forget that liquidity needs of depression days need not control the growth needs of a more prosperous era. Past actions of the home-loan bank, for instance, have discouraged borrowing and at the present time the bank is attempting to make savings and loan associations more liquid.

The important home-finance problem today therefore is not liquidity, but finding means for accelerating the flow of savings from growing institutions such as mutual investment funds, pension funds, retirement funds for State and local governments, into the housing market, and for making the most of these funds once they reach mortgage institutions. The housing market must not be left to depend primarily upon the direct flow of savings to agencies which emphasize mortgages.

This may be expressed in another fashion. To use savings and loan associations as an example: In 1940 the equivalent of about 5 percent of the personal savings went to savings and loan associations. This grew rapidly to about 30 percent in 1955. It dropped to about 24 percent in 1956, and may be down to 20 percent in 1957. With a growing preoccupation with inflation, and with the increased promotion of the stock market and of mutual investment funds, it is natural that families should be more conscious of opportunities to invest in stocks and bonds. They should have this opportunity. But if they do shift their investing habits, there should be counterchanges to make it possible for institutions benefiting from this new investment pattern to participate in the financing of the volume of housing the economy needs. Should savings become institutionalized, that is, should they go only to institutions who loan them to corporations and institutions only and not back to people as in the form of mortgages, housing will be in bad shape. A little imagination and possibly very little legislation will make it possible to balance the flow of funds in both directions.

I suspect that the problem of keeping institutions abreast of changing economic needs is one of the greatest challenges the Government and the economy faces. Unless we have institutions first for 1957, we shall have a volume of housing fit for 1937.

(The appendix to Mr. Newcomb's statement follows:)

Distribution of Households by Size of Household Personal Income After Federal Income Taxes, in 1955 Dollars, for Selected Years, 1929–65

Methodology and Sources of Data

Household distributions in this report were based principally on the family personal income distributions prepared in recent years by the National Income Division of the Department of Commerce. Part I presents the appropriate definitions and concepts which are used in this text, and part II the basic procedures, first for the derivation of the family income distributions, the appropriate numbers, aggregate income and Federal income tax liability, and subsequently the derivation of the household distributions from the family distributions.

Part I. Concepts and Definitions

Households.—Under the current census definition (e. g., P–20, No. 67, p. 5) a household includes all of the persons, related or unrelated, who occupy a dwelling unit. The number of households in the census reports for a given year is the same, after an adjustment for timing, as that used in this report. It is also equal to the number of primary individuals and primary families combined. In the present report, the number of households is estimated as of the end of the calendar year, so as to be consistent with the national income series on family personal income. In the concept of household used here, households are classified at the income levels of the relevant primary families or primary individuals. Income of secondary families and of secondary individuals is not included. Both the numbers and income of quasi-households are excluded. These terms are the same as those used in the census reports.

Primary family is a group of two or more related persons living together, one of whom is the head of the household.

Primary individual is a household head living alone or with nonrelatives only.

Consumer units are families or unattached individuals, as defined in the national income series. (See the Survey of Current Business, June 1956, p. 16.) They include, in addition to the primary families and individuals of households, secondary families and individuals and also consumer units in quasi-households, and exclude individuals in institutions. The numbers of consumer units are estimated as of the end of the calendar year and are otherwise consistent with those published by the Census Bureau in its P–60 series (with the minor exceptiton noted above for individuals).

Family personal income is the current income received by consumer units from all sources, including wages and salaries, other labor income, proprietors' and rental income, dividends, personal interest, and transfer payments. It includes both money and nonmoney items such as wages in kind, the value of food and fuel produced and consumed on the farm, imputed net rental value of owner occupied homes, and imputed interest. It excludes income received by institutional residents, or retained by nonprofit institutions and private trusts, pensions, and welfare funds.

Household personal income is the family personal income received by primary families and primary individuals.

Federal income taxes for a given year represent the aggregate liability reported on individual income tax returns plus adjustments for subsequent audit corrections and minus liability of military personnel not living with their families and minus liability on net capital gain. Two estimates of Federal income taxes have been used in this work; one represents the liability of all consumer units, and is associated with the distribution of consumer units by family personal income level; the other represents the liability of all primary families and individuals and is associated with the distribution of households by household personal income level.

Part II. Methodology

A. *Distribution of consumer units, aggregate family personal income, and Federal income tax liability by family personal income level in current dollars*

Since the household distributions were derived from the consumer unit distributions, the latter will be described first. The distributions for 1935–36 and 1941 for all consumer units by family personal income level, including the control totals of the number of units and aggregate family personal income were taken from Size Distribution of Income Since the Mid-Thirties, by Goldsmith et al., in the February 1954 Review of Economics and Statistics. Distributions were available separately for families and for unattached individuals from unpublished worksheets underlying the article cited above; tax liability estimates by income level were also available for 1941 from these worksheets. For 1935–36, tax liabiilty estimates were first prepared by money income levels of families and individuals (based on unpublished distributions of these groups by money income levels) using the tax rate tables for that year and adjusting the aggregate tax liability as indicated in the definition of this term above. The tax liabilities were then shifted up the income scale with the consumer units as they moved from money income levels to family personal income levels. The adjustment procedure is described below under C in another connection.

For 1929, the distribution of all consumer units combined and their aggregate family personal income, by income level, were based on unofficial estimates prepared by Mrs. Goldsmith in some unpublished work with the author. The 1929 distribution was derived from the Brookings study, America's Capacity to Consume, pp. 227–229, after adjustment for net capital gains and for understatement in business income. The assignment of tax liability by income level was facilitated by the fact that about 95 percent of the tax liability was attached to family personal income at levels above $10,000. The control total amount of aggregate tax liability for 1929 was derived from table 1 of the June 1956 Survey of Current Business article, Income Distribution in the United States, 1952–55. The number of consumer units was broken into separate estimates of the number of families and of unattached individuals in a partly arbitrary fashion, in line with the observed pattern of the two categories among all the other years. The 1929 distributions of families and of unattached individuals were obtained from the 1935–36 distributions of these groups by a procedure described below in obtaining the 1955 families and individuals from the given 1953 distributions. Aggregate income was estimated by income level for each distribution, and taxes were allocated between the two groups at the various levels in direct proportion to their aggregate income.

The separate distributions of consumer units for families and for unattached individuals by family personal income level for 1947 were taken from the supplement to the Survey of Current Business, Income Distribution in the United States, by Size, 1944–50. The distributions of Federal income-tax liability for families and for unattached individuals by family personal income levels were derived from corresponding estimates underlying table 10, for the year 1950, in the article Income Distribution in the United States, 1950–53, in the March 1955 Survey of Current Business. The 1950 data were adjusted to 1947, taking account of the different numbers of consumer units and of aggregate family personal income at the various family personal income classes in the 2 years, and of the tax-rate tables in the upper adjusted gross income classes for 1947. The initially allocated tax amounts were adjusted to the control total of aggregate tax liability for the year 1947 derived from table 1 in the June 1956 article cited above.

The distributions of families and of unattached individuals by family personal income level for 1950 and 1953 were based respectively on data in the March 1955 article and the June 1956 article in the Survey of Current Business, both cited previously. In these articles, Federal income-tax liabilities are given by family personal income level for families and individuals combined. These taxes were allocated to families and individuals separatey at each income level under the assumption of two less exemptions per unattached individual than per family.

For 1955, families and individuals were available only in combined form by family personal income level from the June 1956 article. The amount of Federal income-tax liability was available only in aggregate, and not by family personal income level. The number of families could be estimated separately as of December 31, 1955, by interpolation among the relevant figures in table 4 of census release P–20, No. 68. Unattached individuals were obtained by subtraction from the total number of consumer units in the June 1956 article.

The separate 1953 distributions of families and of unattached individuals were used as a basis for the estimation of the 1955 distributions of families and individuals by income level. First, each of the two 1953 distributions were inflated to the 1955 control population totals. The two inflated distributions were then added across by income level to obtain a preliminary combined distribution. The separate distributions for families and for unattached individuals were then moved up the income scale to 1955 income levels in such a way that the distribution of combined units by income level was identical with the 1955 given distribution. This particular procedure is described in somewhat more detail at the bottom of page 47 of the Income Distribution Supplement to the Survey of Current Business cited above. Aggregate income was estimated for each distribution by income level principally by use of the procedures described in footnote 2, page 33, of the income supplement, and then adjusted proportionately to meet the overall income aggregate. Tax liabilities were estimated by starting with the 1953 amounts by income level and adjusting them in proportion to the changes in aggregate family personal income from 1953 to 1955. Subsequently a final proportionate adjustment was made in all tax amounts to meet the independently estimated tax aggregate derived from table 1 of the June 1956 article.

B. Distribution of households and of household personal income and Federal income-tax liability by size of household personal income

Since no statistical series has been published on the estimated distribution of households by size of household personal income, the present series is based directly upon the published and unpublished consumer unit distributions described in the previous section.

For the years 1929, 1935–36, 1941, 1947, 1950, 1953, and 1955, separate distributions were available for families and for unattached individuals. For each distribution there was given, at each level of family personal income, the number of families or unattached individuals, their aggregate amount of family personal income, and the amount of their Federal income tax liability. For these years there were also available estimates of the total numbers of households as of the end of each year. These estimates were derived where appropriate, from data in Census release P–20, No. 68, or from table B–1 of the appendix to Potential Economic Growth of the United States During the Next Decade, prepared by the staff of the Joint Committee on the Economic Report of the 83d Congress, 2d session. For the postwar years and for 1941, it was possible to break the number of households for each year into primary families and primary individuals. Generally, the number of families among consumer units differed from the corresponding number of primary families among households for the same year by about 1 to 3 percent in a fairly regular pattern over the years. Given the estimated total number of families for 1929 and 1935–36, it was possible to estimate the corresponding number of primary families with reasonable accuracy. The numbers of primary individuals were obtained as residuals.

For the years discussed thus far, the following procedure was now used. It was assumed that primary families, their aggregate income, and tax liability were distributed by income level in the same proportion as all families among consumer units. The same assumption was used for primary individuals with reference to all unattached individuals. For a given year, when both the distributions of families and of unattached individuals, and of their aggregate income and tax liability, had been reduced to primary families and to primary individuals by this procedure, the numbers, aggregate income, and tax liability of the two distributions were added together by income level. The resulting single distribution was the distribution of households by household personal income with the numbers, aggregate income, and tax liability distributed by household personal income level. The total number of households met the given control total, and the overall aggregate income and aggregate tax liability were taken as the totals appropriate to these households.

For 1960 and 1965, Dr. Newcomb's projections of the total number of households, and also of primary families and primary individuals separately (adjusted for timing at the end of the year), were used as controls. Aggregate household income after Federal income taxes in 1955 dollars was estimated initially for 1960 and 1965 by using the ratio of this income to GNP for 1955, a ratio which has held approximately over the 10-year period 1946–55. GNP projections for 1960 and 1965 in the Joint Committee Print, op. cit., table B–4, were used. The two 1965 estimates were averaged. Next, average household income after taxes was computed for 1960 and 1965 and checked by comparing the average annual increase in constant dollars during the postwar period with that for the projected period. This average annual change in real income was approximately the same before and after 1955, and may be taken to reflect the continuation, in a broad sense, of the postwar trends in productivity and household formation. The balance of the procedure for the 1960 and 1965 estimates is described in the following section.

C. Distribution of households by level of household personal income after Federal tax liability in 1955 dollars

The deflated series of household personal income after taxes in 1955 dollars was based on the application of implicit price deflators to the current dollar aggregates derived in the preceding section. These deflators may be derived most directly for many of the years from table 1 of the June 1956 article, op. cit. Price deflators for other years were calculated by reweighting the three basic component deflators of personal consumption expenditures (lines 3, 4, 5, in table 41, p. 216 of National Income, 1954 edition, with the 1955 weights in table 1, p. 7, of the article, National Income and Product in 1955, in the February 1956 Survey of Current Business).

The procedure for taking households from levels of household personal income in current dollars first to levels of household personal income after Federal income taxes in current dollars, and then to levels of household personal income after Federal income taxes in 1955 dollars will not be described here in detail, although in the present work the largest single portion of the computational work was devoted to this task. The first step obviously calls for a differential adjustment, i. e., the higher income households get the greater downward percentage adjustment. The second adjustment was proportional, i. e., all after tax income levels were deflated by the same index. In practice, both steps were combined into a single operation. In this procedure, the implicit assumption exists that at any single income point all households have the same average taxes. In previous work, it has been found that this assumption affects the estimates in only a minor fashion. Further description of the techniques used here may be found in footnote 21, page 61, and footnote 12, page 38, of the Income Supplement, op. cit. The same procedure was used for all of the relevant years from 1929 to 1955.

For 1960 and 1965, the following procedure was used. First, the separate 1955 distributions for primary families and primary individuals were obtained by after-tax income levels in a manner similar to that described in the preceding paragraph. For the 1960 work, these two distributions were then inflated separately by the projected total numbers of primary families and primary individuals and added together by income level. The combined distribution was then moved up the income scale by a proportionate adjustment. (See footnote 12, op. cit.) A similar procedure was used for 1965.

While the differential growth of primary families and primary individuals over the projected period entered into the distributions, the effect upon the after tax Lorenz curve was slight. This is not hard to understand in view of past findings that rather substantial changes in income distribution are necessary to produce any appreciable effect upon the Lorenz curve. For example, the impressive change in income inequality observed between 1935–36 and 1950 is a change of only 14 percent in the index of inequality (footnote 4, p. 7, of the Review of Economics and Statistics article cited above).

Representative MILLS. Our next panelist is Mr. Peter Henle, assistant director of research, the American Federation of Labor-Congress of Industrial Organizations.

Mr. Henle, you are recognized.

Senator O'MAHONEY. Mr. Chairman, may I publicly express my regret at having to leave the session this morning?

The Judiciary Committee is calling for a quorum, and I must go.

STATEMENT OF PETER HENLE, ASSISTANT DIRECTOR OF RESEARCH, AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. HENLE. A lull in economic activities is clearly apparent. Nowhere, at present, is there an indication of strongly rising demands, as there was from consumer spending in 1955 or from business spending for new plant and equipment in 1956. There are only a few signs of added strength on the economic horizon—moderately rising consumer spending and small increases in expenditures by Federal, State, and local governments, but these should provide sufficient underpinning to the economy to prevent any sharp decline in the months immediately ahead.

In the brief time allotted to me, I would like to review briefly a few key economic indicators with emphasis upon labor market data.

Employment: Changes in the labor force during the past few months appear to be largely the result of normal seasonal fluctuations While employment remains high, it nevertheless seems clear that today's labor market cannot be considered as tight.

Although employment in nonagricultural industries shows an 800,000 increase over last year (BLS figures), on a seasonally adjusted basis the total has remained at practically the same level since the closing months of last year.

During the last 6 months, nonfarm wage and salary jobs on a seasonally adjusted basis have about held their own in construction, mining, transportation, and public utilities, banks and insurance companies, services, and retail and wholesale trade. There has been a decline in manufacturing, and an improvement in Government employment.

Focusing on manufacturing, we find that the number of production and maintenance jobs have been declining more sharply than total employment. These declines have not been concentrated in one industry, but have been spreading through most industries in recent months. For April, total production worker employment in manufacturing was almost 200,000 less than April 1956.

Sagging demand for many products, inventory reductions, cost cutting, and rising output per man-hour of work have been causing small, but widespread, layoffs. An indication of the size and spread of these layoffs can be seen from reports of recent weeks:

Admiral Corp. closed its Bloomington, Ill., radio and television plant indefinitely, affecting 600 to 800 workers. Westinghouse laid off 300 appliance workers at Mansfield, Ohio. The Pennsylvania Railroad laid off 1,600 shopworkers throughout its system.

Armour & Co. is closing its Los Angeles meatpacking plant that employed 500 workers. United States Rubber Co. layoffs affected 800 workers in Eau Claire, Wis., and Chicopee Falls, Mass.

We are informed that employment at the General Motors Frigidaire plant in Dayton is now down to 8,000, roughly half the total that prevailed a little more than a year ago.

The building and construction trades department of the AFL-CIO has considered the employment situation in its industry sufficiently serious to have inaugurated a monthly report on unemployment among its building trades councils in 20 cities.

Because this procedure has been operating for only a few months, figures are not sufficient to reach any definite conclusions. In general, they show a great diversity in unemployment rates around the country and indicate in a number of places that the spring movement is not of the dimensions reached in previous years.

Unemployment: Recent unemployment figures by the Census Bureau give total unemployment in April at 2.7 million (new definitions), about 4 percent of the labor force and about the same as in April 1956. However, it is significant that unemployment insurance claims during the early part of the year and continuing through the spring months have been running 100,000 to 200,000 above the comparable level last year. The more detailed statistics showing the characteristics of the insured unemployed emphasizes that, in particular, unemployment among factory and construction workers has been higher this year than in 1956.

On an area basis, the Labor Department's recent Report on Labor Market Areas emphasizes the diversity of labor-market conditions throughout the country. In some areas, the labor-supply situation can be characterized as rather tight, but at the other end of the spectrum there are 21 major labor-market areas and 59 smaller areas included as areas of substantial labor surplus. This is roughly the same number as May of last year. Since the previous report in March, 6 areas have been reclassified as a result of improvements in their employment situation, but for 5 of these the improved employment outlook stemmed mainly from seasonal factors. On the other hand, there were 8 labor market areas in 6 States where changes in classification were made reflecting greater unemployment. Included in this group were the following cities (listed with the industries in which layoffs have occurred): Flint and Grand Rapids, Mich. (auto and auto parts); Dayton, Ohio (appliances); New Britain, Conn. (fabricated metals); and San Francisco-Oakland, Calif. (construction, trade, shipbuilding, autos).

Hours of work: Both the Census Bureau and the BLS report continuing significant reductions in hours worked. In a comparison of April 1956 and 1957, the Census reports a reduction in the extent of overtime and an increase in part-time work due to economic causes. The number of workers usually working full time, who were working part time in April of this year, was 1.2 million, 200,000 above the level of April 1956.

A sharper trend is evident from BLS figures, which show that the average weekly hours worked in manufacturing industries has dropped from 40.7 in September and October to 39.9 in April. This is the first time the figure has gone below 40 hours since the 1954 recession.

Productivity: Considerable controversy has been evoked in recent months over the interpretation of recent trends in productivity. The President's Economic Report, for example, argued that, during 1956, "only a very small gain in overall productivity is indicated." It has been generally agreed, however, that productivity changes may fluctuate rather sharply from year to year, and therefore the figures for any one year must be viewed in their proper perspective.

The value of this caution seems to be borne out by more recent events. The trend of the economy in the last 6 months would seem to indicate a significant increase in productivity, for at least manufacturing, since total man-hours have been declining more rapidly than industrial output. The result is bound to have been an increase in productivity, although the exact magnitude of this increase would be difficult to measure.

Other economic indicators could be cited to support the general conclusion that while the economic activity remains at a high level, the movement during the past few months has been more sideways than upward.

I would like to support one conclusion that might be drawn if this analysis is correct. The mood of the present session of Congress appears strongly to be one of "economy." Congress as a whole seems to be hesitant to embark on any new Federal programs. One reason that is advanced for this hesitation is the possible "inflationary" impact of any new venture by the Federal Government.

I would like to suggest that the current economic scene does not require that economic considerations be a primary factor in congressional decisions regarding such issues as aid to school construction, expanded housing program, aid to distressed areas, and extension of the statutory minimum wage.

Certainly, individuals may differ with organized labor's view that such legislation would help to develop a healthier economy in this country. But equally as certainly, the present economic situation does not require that these programs be dismissed out of hand simply because they might have an "inflationary" effect. Rather, each of them should be considered on its merits, and this committee should make this point clear to the Congress.

Representative MILLS. Our next panelist is Mr. Walter E. Hoadley, treasurer of the Armstrong Cork Co.

Mr. Hoadley, you are recognized.

STATEMENT OF WALTER E. HOADLEY, JR., TREASURER, ARMSTRONG CORK CO., LANCASTER, PA.

Mr. HOADLEY. Thank you, Mr. Chairman.

For perspective it should be noted at the outset that since 1955 the Nation's growth rate has slowed considerably, especially when measured in physical terms. Gross national product—admittedly an inadequate measure because of major gaps in underlying economic statistics—expanded between 7 and 8 percent in both current and constant dollars in the calendar year 1955. The dollar gain in the calendar year 1956 was somewhat more than 5 percent but only about 2 percent in real terms. Present prospects for 1957 indicate a dollar advance of 4 to 5 percent, but only 1 to 2 percent in physical units. Confirming this economic slowdown, industrial production actually has shown a slight decline in recent months.

Here is at least some evidence which suggests that the economy is approaching a temporary crest in general activity. In my judgment, the Nation has entered an "interim period" or economic plateau during which growth will be limited. This "interim period" lies between (1) the broad postwar expansion period of the past decade which was rooted heavily in depression and war-born shortages, marked increases in family formations, and war-inflated purchasing power; and (2) another period of strong forward movement in the economy a few years hence based upon new shortages arising from research innovations accelerating the obsolescence of many existing products and processes, another major wave of family formations, and further marked advances in living standards and buying power.

This interim period is largely the result of the gradual achievement of a much better balance between supply and demand in an increasing number of domestic and international markets, in contrast to the acute supply deficiencies and sellers' market conditions which dominated the United States and world economic activity throughout most of the past decade. More new industrial capacity will come into actual production this year than in any comparable period in history, and much more is scheduled for 1958. The hectic postwar production race to provide adequate capacity for a wide range of civilian-type goods—while at the same time expanding facilities for large-scale and complex defense materials—now seems to be nearing an end for the time being. Quite understandably, a no less vigorous race is now getting under way to sell the output of the enormously expanded new plant capacity, not to mention the production of older plants as well. Competition is becoming increasingly keen and is almost certain to intensify over the coming year. Prudent managements in these circumstances are unlikely to rush to add as much new industrial capacity as in the recent past except as they find major demonstrable advantages in new processes and products which will insure satisfactory profits. This does not mean investment in plant and equipment will drop sharply, but does suggest little further lift to the general economy will come from this source.

Home building illustrates both the impact of interim period conditions and the continuing opportunities for growth even in the face of some shrinkage in primary new home demand. Great dissatisfaction with present housing is still very evident across the Nation. Nevertheless, as a result of the roughly 12 million new dwelling units built since the end of World War II, a much better balance now exists between the national housing stock and the number of families requiring shelter. Tight money conditions are definitely having restrictive effects upon new home building, but the recent drop in new home construction, in my opinion, is not wholly attributable to tight money conditions. Other factors include a marked reduction in the urgency to buy, the necessity of a majority of prospective buyers to dispose of an older home before completing the purchase of a new one, rising costs which are pricing many would-be buyers out of the market, and a current relatively low rate of family formations. Reflecting the strong underlying demand for new homes and some slight easing in mortgage credit, a bottom now seems to have been reached in the recent decline in new housing starts. Some moderate improvement toward the 1 million annual housing start rate is in prospect.

The strong demand for more modern housing and particularly for more space to accommodate growing families offers a continuing bulwark to the residential building market. Millions of families are engaged in making improvements to their existing homes and give every indication of continuing to do so. It is unfortunate indeed that there are no reliable statistics to show the magnitude of this "fix-up" activity, for if they were available I am confident they would throw much needed light on the recent and current overall level of activity in the residential building field. Suffice it to say that repair and modernization activity provides a strong cushion or even an important basis for growth for organizations able to capitalize upon the opportunities available.

Turning our attention to inventories, the skill with which they have been managed in recent years suggests that less instability in the economy can be expected from this source over the period ahead. Tight money conditions, reduced financial liquidity, rising fear of product obsolescence, improved inventory control techniques, and related factors mitigate against heavy inventory accumulation. Increasing competition, plus demands for better customer service, will go a long way toward preventing undue inventory liquidation. Accordingly, inventory changes are unlikely to affect the course of general business significantly over the year ahead.

The principal problems of the "interim period" are likely to be those which arise because many people in public and private life have become so accustomed to rapid growth that they may be unwilling to consider any period of leveling or moderate advance as acceptable, even with the excellent near-term prospects of further resumption of major growth rates. The economy has demonstrated throughout the postwar years that it can move forward despite numerous essential adjustments among individual industries. More rolling adjustments will characterize the interim period. Moves to bolster sectors of the economy which are experiencing inevitable and necessary adjustments preparatory to new growth ahead can be self-defeating to the extent that more inflation results and the corrections are merely postponed.

In my judgment, the economic outlook is for very moderate advances over the remainder of 1957 and in 1958, with most of the gains in dollar measures, reflecting more upward wage-cost-price pressures rather than expanded physical output. Widely divergent trends among industries and communities will be observed.

Much these same conditions have prevailed in recent months. Monetary and fiscal policies have been designed to check inflation which, in my opinion, has been and still continues to be dominant economic problem. Looking to the future, however, the many economic crosscurrents on the horizon pose grave responsibilities upon public and private leadership. More inflation seems almost certain, but how long it will persist is not clear. While gearing basic policies and programs to long-term growth, a high degree of flexibility will be necessary in making current and near-term policy decisions. Constant attention must be given to maintaining a spirit of realism and confidence across the Nation without touching off new waves of inflationary actions. This is admittedly a difficult and delicate task.

One obvious need is a still better program of gathering economic information for policymakers in Government and elsewhere to provide much more comprehensive and reliable data on what actually is happening. Without dependable current information, appropriate policy decisions in the interim period will be virtually impossible.

Representative MILLS. Let me thank you, gentlemen, for your very informative statements.

Those portions of your statements which were not included in your oral testimony will be included in the record, if there is no objection. The Chair hears none.

Senator Douglas, would you like to begin the inquiry?

Senator DOUGLAS. I am a little bit puzzled by what seem to be, on the surface, some differences of opinion among the witnesses, but which may not be differences if they are fully explained.

Mr. Ulin stated that capital investments for 1957 were going to exceed 1956 and would be at least as great in 1958 as in 1957.

Mr. Friend stated, on page 3, in the second paragraph:

> Recent surveys of the outlook for investment in plant and equipment over the next year or so—including surveys of business plans to invest, actual capital appropriations by business, and expected sales by capital goods producers—suggest little change in the rate of expenditures on plant and equipment during this period.

Mr. Hoadley, at the top of page 2, says:

More new industrial capacity will come into actual production this year than in any comparable period in history, and much more is scheduled for 1958.

I know there are timelags in these matters between investment and expenditures, but I would like to find out if there is any consensus as to what is likely to happen for the remainder of this year and for 1958.

Mr. HOADLEY. Senator, may I interpret my particular comment?

The emphasis which I tried to give was on capacity coming into actual production, which differs from the plant and equipment expenditures that are made regularly as new facilities are constructed; for example, funds paid out of our company treasury for new plants do us very little good in terms of actual production until the job is completed.

Senator DOUGLAS. In other words, your statement was based on investment in 1955 and 1956?

Mr. HOADLEY. I had in mind plants which are now coming into effective use. When such plants have to be "debugged," as we refer to start-up difficulties, especially when there is pioneering of processes and materials, there is a great deal of lag between expenditures and profitable output.

Senator DOUGLAS. That clears up some of the differences.

Then the only question is whether you agree with Mr. Ulin. Do you agree there will be a gradual increase in investment during the current year?

Mr. HOADLEY. I believe the prospects are for a very gradual increase. Certainly there is no evidence of any decline in the offing, but the rate of increase is definitely slowing.

Senator DOUGLAS. Mr. Friend?

Mr. FRIEND. I think the only difference between the data that Mr. Ulin presented and the statement I made lies in the dates referred to. I was comparing what was going to happen during the rest of this year with the first half. While he presents data showing a fairly significant increase of 1957 over 1956, most of that increase has already taken place in the first half of this year. So the change from the first half to the second half should be modest indeed.

Mr. ULIN. That is true. The increase from now on will not be as great as in comparing the full calendar year with the previous calendar year.

Senator DOUGLAS. Do you all, then, seem to agree that as of the present time you do not expect appreciable future increases during the next year or year and a half?

Mr. HOADLEY. I would agree.

Mr. ULIN. I agree that plant investment will be relatively stable. Considering the great magnitude of the total figure, the changes during the next 12 months are not likely to be significant, except—and this was my point—that even a very small increase indicates continuing strength, and not a sudden weakening.

Senator DOUGLAS. Now, are you all in agreement that during 1956 there was not an appreciable increase in productivity per man-hour?

Mr. ULIN. I have no opinion on that, sir.

Mr. HOADLEY. We wish we had some data, Senator. Unfortunately we can only speak of experiences that are close to our own operations. I would say there is a certain amount of evidence that productivity increases were limited in 1956.

Senator DOUGLAS. You would have very good figures, I would think, for manufacturing. There is an index of physical productivity, and an index of numbers employed, and an index of average hours worked; so that I should think that one could get a figure of total man-hours worked which could be used to divide the index of production. I suppose you have carried that through. I have not had time to do it.

What does it show for 1956? I have read that it does not show an increase in productivity per man-hour for 1956 as compared to 1955.

Mr. HOADLEY. That certainly is the impression that one gets from making the sort of calculation which you have mentioned. Unfortunately, the data are crude. There are great controversies as to definition and coverage. But I believe that it is widely accepted that the productivity increase last year was below the long-term average, which is variously estimated to be around 3 percent per year.

Senator DOUGLAS. Does anyone want to make a comment on that?

Mr. HENLE. What I would like to say is this: Certainly it is true from the very rough data that, taking the year of 1956 as a whole, 1956 shows very little increase in productivity over the previous year. In our talks with the Government people who work on this problem more intensely, we find there is some inclination to say that the curve of productivity, judging from the manpower figures and the output figures, seems to have improved in the last several months.

Senator DOUGLAS. I notice that what you are apparently saying there is that during the last 3 to 5 months, with the decrease in the numbers employed in manufacturing of approximately 1 percent, as I work it out from these figures, and with the decrease in hours worked per week, of approximately 2 percent, output has remained approximately constant, which would indicate, as you seem to imply, an increase in productivity per man-hour of somewhere around 3 percent. Is that not right?

Mr. HENLE. That is correct. And this goes back to some time last fall, about the last 6 or 7 months. And I think the people who have looked at the figures for individual industries would confirm that—cautiously, of course.

Senator DOUGLAS. The thing which worries all of us, and which worries you, too, is whether we may expect an increase (*a*) in industrial prices, particularly capital goods, where the increase has been most constant, and (*b*) in the cost of living. And I did not get any clear impression that there was any consensus on that point.

I wondered, Mr. Chairman, if they would be willing to express themselves on that point?

Mr. ULIN. I think some increases, some further increases, in capital-goods prices may occur, as a result of cost increases which have already been incurred by the capital-goods producers in the last several months.

Senator DOUGLAS. Do you refer to wage increases?

Mr. ULIN. Some of them have already paid wage increases, and others are committed to wage increases under existing contracts with cost-of-living provisions. There have been some freight-rate increases. There have been some increases in the extra charges, and so on, for steel, and there may be more.

However, with the trend of new orders leveling out, I think it is unlikely that price increases will be as great as in the recent past for capital goods.

Mr. TONGUE. With respect to food, which is our business in particular, we have had an upward trend of food prices in the past 6 months, which has been a reflection of rising farm prices, rising returns to farmers. I would expect that we are now close to the seasonal peak in such prices, although they have not been reported yet; and the figures to be reported for May and June will undoubtedly be higher than those for April. But after that I would expect a relatively level trend through the balance of this year. The food segment of the cost-of-living index would probably be somewhat higher than it was in April for the rest of this year, though still below the highs of the Korean war period, 1951–52.

I see nothing in the general picture to suggest that what has been characterized as an upward creep would be halted, and there is every indication that this would continue as to the general price level.

Senator DOUGLAS. May I ask if others would be willing to express themselves on this point?

Mr. FRIEND. I would think with the moderate increase in demand pressures that we are likely to get over the next year, plus some additional pressures on the wage side, we would have modest increases in prices, assuming that Government expenditures remain pretty much as they are budgeted for this next year.

I would assume, on the other hand, if we get a moderate decline in Government expenditures, this might very well offset this upward creep in prices.

Mr. NEWCOMB. May I throw another concept in here? The profits picture for the first quarter of this year has been much higher than many economists have been forecasting. It suggests to me that industry has learned how to put profits as well as the income tax into its pricing structure. As wages rise, industry must have higher profits to get the money to purchase more equipment. But the technique of putting profits into the pricing system may mean that inflation of this sort will continue until, as has been mentioned here, capacity becomes more adequate.

Senator DOUGLAS. Are you speaking of income, or profits?

Mr. NEWCOMB. Profits.

Senator DOUGLAS. So you are saying that they have now become a cost and not a residual?

Mr. NEWCOMB. In more cases, probably. Yes.

Mr. TONGUE. May I take some exception to that statement, Senator? I do not think there is any evidence that profits have shown any increase recently. True, the first-quarter figure is above the average for last year, which includes some poor figures. But I think over the broad sweep, taking it from 1929 to date, or at least through 1955, the share of the "capitalist element," if you want to call it that, has shown virtually no change whatever in relation to sales.

Mr. HOADLEY. Senator, I would simply add this comment: That despite the fact that overall profit estimates—and that is all they can be—have shown some tendency to move up during the first quarter, a very large number of the companies reporting showed profit decreases; overall profit figures present a very misleading average picture.

Senator DOUGLAS. They tend to be the smaller companies?

Mr. HOADLEY. Not necessarily. Our profits went down 23 percent during the first quarter as compared with a year ago.

Senator DOUGLAS. But taking the corporations according to size, it is the small companies that show the decrease; is that not true?

Mr. HOADLEY. Well, I am sure that many small companies have——

Senator DOUGLAS. Oh, certainly. The profits of many small companies have gone up and those of many large companies have gone down. But taking the small companies as a group and the medium-sized companies and then the large companies in general, the increase in the rate of profits has varied according to size. Is that not true? And the smaller companies have actually lost ground. Is that not so?

Mr. HOADLEY. There is some statistical evidence tending to indicate what you say. But, here again, I would underline what was said earlier. Available profit data are highly incomplete. We have no reliable basis for reaching definite conclusions about the current trend of profits in total or by size of company. However, this is not necessarily to say that I am disagreeing with your conclusion.

Mr. NEWCOMB. What I have mentioned, if true, may not be an invidious development.

Senator DOUGLAS. I am not saying it is invidious. I am merely saying it is a fact.

Mr. TONGUE. The first quarter figures were very heavily weighted by the large oil companies' results. And, of course, these will not show the same increase over the balance of the year.

Mr. HOADLEY. A very good point.

Senator DOUGLAS. Mr. Chairman, I will ask one more question, and then I will let you take over.

Prices have been increasing over the last 2 years, particularly during the last year, but the total volume of money has not been increasing. I am consulting our Economic Indicators here; and on page 26, figures taken from the Federal Reserve Board show that in 1955 the total deposits, plus currency, were $221 billion. In March 1956, $221.5 billion. That is virtually the same physical quantity of money, i. e., demand deposits plus currency. Yet the price level has gone up.

Now, under the quantity theory of money the only possible answer to why that has happened would be an increase in the velocity of circulation. Now, I wondered if you had any judgment on that. Has there been an increase in the velocity of circulation?

Mr. FRIEND. Almost by definition there would have to be increased velocity. I think this is a good indication that the pure quantity theory, if it has any validity at all, does not have much validity in the short run.

Senator DOUGLAS. The question I was wondering about was whether it was the increased velocity of circulation which had caused the increase in the price level or whether the increase in the price level, accompanied by restrictive credit policies by the Federal Reserve, enforced an increase in the velocity of circulation. I would like to hear a little argument on that point.

Mr. FRIEND. I would feel that it was the Federal Reserve policies and economic conditions generally which activated the increase in velocity.

Senator DOUGLAS. You mean the Federal Reserve held down the total quantity, but individual prices went up?

Mr. FRIEND. Yes.

Senator DOUGLAS. And that, therefore, in order to enable the sum total of individual prices to rise, velocity had to expand.

Mr. FRIEND. That is right. As a matter of fact, that is probably particularly true in the corporate sector, where, as you know, liquidity was reduced very considerably. This was probably a major element in the increase in velocity last year.

Senator DOUGLAS. I wonder if others would express themselves on this.

Mr. ULIN. Well, if I might express a rather simple concept, Senator, I think that many corporations have learned how to make their dollars work harder. In the capital-goods field particularly, although the reported prices of these capital goods have shown rather substantial increases in the past year or two, the capital goods that are actually being bought are quite different from the older types, and they are much more productive. If we had some way of pricing a capital good in terms of the amount of work it will do, I think the actual cost to the corporation would be quite a lot less. So that a dollar spent for capital goods in the past year has done a great deal more work than a dollar spent in the previous year. And that has been some help.

Mr. Hoadley has more direct experience in the management of inventories than I do, but it is my impression that most companies have improved their inventory-control techniques in the past year and managed to make their inventory dollars work harder also.

Senator DOUGLAS. What do you mean by "making dollars work harder"? I had always thought they were inanimate. Now, how does a dollar work harder?

Mr. ULIN. Well, what I am saying is that——

Senator DOUGLAS. Smaller bank balances, you mean?

Mr. ULIN. No; I am saying that management is concentrating on the most productive use of its cash resources, so that the money is paid back quickly. Investing $5,000 in a new machine today, compared with say $3,000 a year or 2 ago, may be getting the company 5 or more units of output, compared with 3 from the old machine. So the price increase may be offset by the greater efficiency of investment. For this reason, the price increase is not as much as it looks for capital goods, and that accounts for some of the gap between the reported increase in general prices and the increase in money supply.

Mr. HOADLEY. I think it is safe to say, Senator, that corporation treasurers are watching their balances as closely as they ever have in history, and probably more so. Liquidity is highly relevant to this discussion. Inventory turnover has been accelerated. Similarly, receivables have been watched very closely to maintain a satisfactory collection rate. A great deal of time and energy is now being spent trying to get the greatest possible use of money, even by hour and day, across the country.

Senator DOUGLAS. Now, why are you doing that more in 1957 than you did in 1955?

Mr. HOADLEY. Simply, Senator, because of the liquidity problem. With heavy capital-expenditure programs, with rising wage costs, with raw material price increases, and in many respects an unfavorable environment in which to do long-term financing——

Senator DOUGLAS. You mean the increase in the interest rate has forced you to keep smaller balances?

Mr. HOADLEY. Let me put it this way, Senator: In a company such as ours, we necessarily have to maintain increasing balances as we continue to grow. As a result, we have certain problems trying to balance the capital which is readily available to us from internal sources against rising expenditures for plant and equipment, for higher wages, and materials and other items. We have to get money on the outside from time to time. We are very conscious of interest rate levels and trends, to be sure, but essentially we try to avoid any undue borrowing. We want to keep our company on a sound financial basis.

Senator DOUGLAS. But that would presumably be operative at all times, and in 1955 as much as in 1957. Now, how is it that you have become more conscious of this in 1957?

Mr. HOADLEY. Senator, either because of an accident, or, as we like to believe, long-range planning, we anticipated that we would need a considerable increase in capacity in the period 1956–57. So we accumulated funds during the period 1954–55, which would enable us to take care of a great many of these expenditures. We had investments in Treasury bills and other securities, which we have since liquidated, in order to convert that money into new productive capacity. We have now reached the stage where further expansion will depend more on new outside money than was true in the previous period. It is all a matter of liquidity.

Representative MILLS. Gentlemen, you will recall that in the hearings conducted by the Joint Economic Committee in February with respect to the President's economic message, we were concerned, in part, with the question whether inflationary trends and pressures of inflation would be greater in 1957 than they were in 1956. It was pointed out to us at that time that perhaps the only factor that might give us a boom and further inflation might be Government spending. I have personally been concerned, therefore, as to whether or not the program that appears to be underway in the Congress, of endeavoring to reduce Government spending below the amounts estimated by the President for the coming fiscal year, would have an effect upon this outlook brought out during the February hearings.

I have a fundamental question about our entire situation, which I want to pose to you.

Have we reached the stage in our economy with Government spending and Government revenues equaling as much as one-sixth of our overall gross national product that it is impossible for us to have steady growth without having these projected expenditures by Government?

Would anyone care to comment on that, as we look to the future economically?

Mr. TONGUE. I will take a shot at that, if I may, sir. I would say definitely no. I believe we can have progress in the economy with a declining trend of Federal expenditures. In fact, I think economic progress would be greater. This is a very hazy field, I confess, as to what is progress and what is not But I mean in terms of improvement in the standard of living of the people and building up our capital assets.

Now, I confess that there are difficult problems of scheduling, anticipation, and so on. But I do not think they would be any greater with a declining trend of Government expenditures, Federal expenditures, than they have been in the past several years.

As I have heard Mr. Ulin say on another occasion, or infer at least, the job of business forecasting might not be so difficult if we were confined to the private sector alone. The difficult problem has been to project the Government's sphere of activity, which has been subject to changes, the magnitude of which has been very difficult to assess. I therefore think the economy could adjust to a declining trend of Government expenditures if it could anticipate that those expenditure savings would be offset by tax reduction. You could have a release of resources, and they would flow into private activity as against Government activity. I believe the private activity would be more productive than the Government.

Representative MILLS. I have always thought that it was possible for us to have economic growth over a period of time when Government expenditures were declining. But it is essential, is it not, that fiscal and monetary policies be readjusted to take into consideration those changes in budgetary policy? If we have reached the point where Government spending may be directed downward, as a result of congressional action, I thought it would be advisable for us, in the course of these hearings, to understand more fully what changes would have to occur in fiscal policy to accompany those downward changes in Government spending.

Professor Friend?

Mr. FRIEND. I was just going to take a slight exception to the remarks Mr. Tongue made.

First of all, I agree that, if you have declining Government expenditures, there is no reason why this should not be coincident with economic growth.

Second, I am in agreement that, if you have a substantial decline in Government expenditures in the present economic situation, you ought to associate this with tax reduction.

But I do want to take exception to the notion that for some reason our economic growth will necessarily be increased or enhanced. It may very well be. I do not know. But I am not very sympathetic with the notion that our economic growth has not been proceeding at a satisfactory rate for the past 10 or so years, when Government expenditures have been at the highest peacetime level in our history, relatively and absolutely.

Mr. TONGUE. I think the position of the consumer must be considered, as well. It would build up his level of living, general satisfaction, and so forth. This is, of course, a value judgment, a personal opinion.

Mr. FRIEND. In other words, you do not really think the consumer wants what the Government is now providing him with?

Mr. TONGUE. Yes. That is right. Within limits, I feel consumers would prefer to spend some of the money themselves that is now spent, ostensibly in their behalf, by Government.

Mr. FRIEND. One final point is relevant here. I think the level of Government expenditures should be decided only in a secondary sense with a view to the economic outlook. I think that the country can pretty much afford within reasonable limits what it feels it needs.

What I am saying, in effect, is that if we do not feel we need certain expenditures now we ought to cut them. There are other devices for controlling the cyclical impact of such a cutback. If we feel that certain things are highly urgent, that we do not now have, we can add them.

My own personal preferences at the moment probably would be on the cutback side. But I think it is one thing to have personal preferences. It is quite another to state that for some reason or another this somehow improves the economy.

Mr. HENLE. I am glad Professor Friend brought this out, because this is the point I was trying to make in my statement. I judged from the statements of all the group around the table that no one here feels that the present economic outlook is one of, certainly, rampant inflation, and in response to Senator Douglas we sort of indicated that prices are perhaps more under control or will be in the near future more under control than they have been in the past.

Moreover, with regard to spending by the Federal Government, although it is true we have had a pretty high level of Federal Government spending, if you look at the share of the gross national product to which the Federal Government is contributing, that share today is lower than it has been over the past 2, 3, or 4 years. In other words, it went up during the Korean war, of course, and has been declining since then.

Of course, the share of the State and local governments has continually been on the increase.

Mr. NEWCOMB. Could I put that in another frame of reference? State and local, Federal nonmilitary, and Federal military. When you break it down that way, you are going to have a lot of trouble getting less schools and less roads in the State and local. You are going to have a lot of trouble getting less highways in the Federal nonmilitary. As to the Federal military, I have no idea. But putting the State and local and the Federal nonmilitary together, the grand total will have to go up with the rise in schools and water and sewer and highways and what have you.

Mr. HOADLEY. Is it not true, Mr. Chairman, that the big problem we face today arises because of efforts to try to get everything done for everybody in a limited period of time? There are many things which people want, but everything cannot be done at once. After all, the Nation has limited resources. To try to do too much too soon is simply to defeat the whole process. Government spending must not be allowed to get out of hand; eventual broad tax cuts are essential. Certainly our economy can continue to grow and remain very healthy, but if we try to do too much too soon, then inevitably some groups and the whole economy will suffer.

Speaking at least from a business standpoint, I detect as much long-range optimism now as at any time. The general feeling is that we do have a strong country that will continue to grow. But there is little expectation that the economy can set new records every week or every month. Moreover, it will be necessary to face temporary adjustments as we go along. If we take these adjustments in stride, as I am confident we can, then I visualize that the economy can continue to grow without rising Government expenditures.

Representative MILLS. Professor Friend, I would not want you to misunderstand me. Our purpose is not to determine whether we should, from the point of view of economics, reduce expenditures of

Government, but rather to determine, if we can, the compensatory action that we should take if such reductions in spending do occur.

Senator Douglas?

Senator DOUGLAS. I was somewhat struck by the fact that a number of the members of the panel seemed to say, first, that we were going to be at a relatively high level of prosperity for the coming year, and, second, that if an appreciable reduction in expenditures did occur, taxes should be reduced.

Now, I had thought that the accepted compensatory theory of public finance was that in a period of prosperity you should devote the surplus to paying off a portion of the bank-held public debt in order to reduce the amounts available for credit expansion.

Would that be inappropriate, Mr. Chairman, if I asked that question?

Representative MILLS. Not at all.

Senator DOUGLAS. You evidently are more afraid of a recession than of a further boom, Mr. Friend.

Mr. FRIEND. I am. If we have a Federal expenditure reduction of over five billion. You may recall in my statement I said that if we have a reduction in currently budgeted expenditures of less than five billion, I would not recommend tax reduction.

Senator DOUGLAS. That is, if it were 1 billion or 3 billion?

Mr. FRIEND. If it were 1 or 2 billion I would not do anything at all. If you want me to, I think I might justify these rather arbitrary limits, though admittedly in not too satisfactory a manner. But from 2 to 5 billion, I would——

Senator DOUGLAS. You would reduce the bank-held public debt?

Mr. FRIEND. What I would do is to take the various measures which are possible for the Federal Reserve and Treasury in easing monetary conditions, such as open market operations, et cetera.

Senator DOUGLAS. But would you use the surplus?

Mr. FRIEND. Yes. I would have the public debt reduced.

Senator DOUGLAS. Might we ask the others if we feel that way, Mr. Chairman? In the case of reductions of, say, 1 to 3 billions?

Mr. TONGUE. One to three billions? I agree that nothing should be done in the present circumstances.

Mr. HOADLEY. To reduce taxes?

Mr. TONGUE. That is right. To reduce taxes, under present conditions. You should use the surplus then to retire the debt.

Mr. HENLE. I would agree that total tax revenue should remain high, but I would add that I think there are a lot of things wrong with the tax structure that we can fix up, without cutting the total revenue.

Mr. TONGUE. Shall we get into that subject?

Mr. HOADLEY. We are all agreed there are a lot of things wrong with the present tax structure.

Mr. TONGUE. But we might disagree on what those are.

Mr. FRIEND. May I make one further point?

I would agree with what I gather is your premise, that with the level of national income in prospect, and with a moderate—up to $5 billion—reduction in Government expenditures, we should have a modest surplus.

Senator DOUGLAS. And that surplus be devoted to——

Mr. FRIEND. I do not really think it is terribly important what it is devoted to.

Senator DOUGLAS. Well, it might be used, you see, to increase the deposits of the Treasury in the banks, for which the Treasury receives no interest.

Mr. FRIEND. It seems to me this is a secondary consideration. But I am perfectly willing to have the public debt reduced, as I indicated earlier.

Mr. HOADLEY. If I may, Mr. Chairman, I'd like to make one further point. It seems to me that in this period when we are not really clear as to the direction in which the economy is going over the coming year it is highly important that accurate current information on economic developments be available. If it were my responsibility in theory to help determine public policy in the field of residential construction, I would be appalled at how little reliable information I would have available to guide decisions. I think it is critically important that leaders in Government, and outside of Government, who are going to be making decisions in the next 12 to 18 months have better information in many fields than is now available. I do not see how we can expect to have flexible policies and appropriate policy changes if we really do not know more about economic trends.

Mr. HENLE. I certainly support Mr. Hoadley on this point about better economic and statistical information; and as I think the joint committee already knows, a group of us from business and labor and agriculture have formed a Federal Statistics Users Conference to work toward this end.

Representative MILLS. Gentlemen, do you consider that inflationary pressures are as great now as they were in February and March of this year, when we filed the report of the Joint Economic Committee? Should they be given as much weight by the Congress now, in determining fiscal policy, as they were entitled to receive in February and March of this year?

Mr. Hoadley, you have described an interim period in which we may continue to grow and have some inflation, but would you care to comment on whether or not the inflationary pressure for the months ahead may be as great as we thought it would be when we last looked at the situation in February of this year?

Mr. HOADLEY. Mr. Chairman, I would say there would be relatively little difference from the February situation with respect to the near-term inflationary outlook. In other words, in my judgment, inflation is still the No. 1 economic problem confronting the Nation. This is primarily because of the strong inflationary psychology with respect to wage increases, many rising costs, including freight-rate increases, and many of the other items. Simultaneously physical production and employment are fairly stable. As I tried to point out in my initial statement, these inflationary tendencies are not likely to continue indefinitely because of the tremendous increases in new capacity which are now coming into production.

The output from this capacity, I think, will take the edge off many price increases as we get further along into 1958 and into 1959.

Representative MILLS. Mr. Henle, could I have your comment on the question?

Mr. HENLE. Well, I would be willing to stick my neck out and say that, in general, I think the inflationary pressure is easier and should be somewhat less of a consideration now than it was at the time you made your report in February.

As I indicated in my statement, I do not see any immediate recession, or any serious decline, in economic activity. I think overall economic activity will remain high. At the same time, I do not see any major factor pushing the economy to substantially higher levels.

Reports have been given here of new capacity and fairly successful profit levels in the first quarter of this year. I think that, although there will be continuing increases in wages, for the rest of this year I see for the most part wage increases based on previous price increases, plus a relatively adequate or modest improvement which can come out of increases in productivity.

For these reasons, I do not feel that inflation is a major threat at the present time.

Representative MILLS. Does anyone else desire to comment? Mr. Tongue?

Mr. TONGUE. Yes. I feel inflationary pressures are likely to be greater as I look at the future than I thought in February. First of all, in the past 6 months we have been through an inventory adjustment. That is, we have shifted from accumulating something over $4 billion per annum in the fourth quarter of last year to some minus figure currently, probably of the order of a couple of billion dollars or so. Thus we have had a $6 billion or more depressing influence on the economy. And at the same time prices have been rising.

Now, I would guess that, as we work through the summer, this factor may not give us any lift, but by the end of the year the cessation of inventory liquidation is going to give quite a lift to business activity from the demand side.

Now, from the cost side, which has been brought in here, we know as a fact that wage increases, which constitute the bulk of the spending power of the country, have been as great so far this year, during this period of adjustment that I mentioned, as they were a year ago. And in the pattern-setting industries, we face wage increases at the middle of the year as great as those last year, partly due to cost-of-living adjustments. But, for whatever reason granted, these will add to the spending power of the people during the second half of the year. And the wage increases granted in the pattern-setting industries will spread to other industries.

At one time, the distributive industries would lag behind gains in income in manufacturing, for example. But nowadays this kind of thing is an annual matter, and, once the pattern is set, everybody goes along with it without very much hesitation.

I believe that the change in psychology toward wage increases has progressed another notch in the past year or so, and that the readiness to grant wage increases is much greater among business people than it was even a year ago. They do not fear that it will destroy their profits. Because, after all, the buying power of the public consists of wages. When wages go up, consumers spend more money, and it is possible to get the higher costs back in higher prices.

Mr. HOADLEY. I am sure many business managements would take exception to that last view of yours.

Mr. TONGUE. This is a general pattern, and I view it with great concern, frankly.

Representative MILLS. Mr. Tongue, do you think we may be this year in somewhat the same situation we were last year? At this time last year we were told there was a serious threat of price increases for the remainder of the year.

Are you saying that we may this year experience somewhat the same price increases that we experienced last year?

Mr. TONGUE. Yes, sir.

Representative MILLS. Do you gentlemen agree or disagree with this statement?

Mr. HOADLEY. I would say not quite to the same degree, but the direction would be up.

Representative MILLS. Further increases in cost of living then?

Mr. HOADLEY. I am afraid so.

Representative MILLS. For the remainder of this year?

Mr. HOADLEY. Yes.

Representative MILLS. Do you agree, Mr. Henle?

Mr. HENLE. Well, I certainly do not expect the price levels to go down. On the other hand, it seems to me that many of the more sensitive prices have stopped rising. And from that I would expect that the increases in the next 6 months would not be as great as the increases of a year ago.

Representative MILLS. Mr. Newcomb?

Mr. NEWCOMB. In the first 4 months of this year new money issues were about 45 percent higher than in the same period of 1956. The forecast this year was for an increase of about 20 percent. I wonder if the companies may not have been doing more floating in the first half of this year than they will relatively in the last.

So this may offset part of the inflationary pressure that Mr. Tongue mentioned would be coming when we started building inventory.

Mr. HOADLEY. I am sure there will be some offset from this direction.

Mr. ULIN. I would not deny the pressures Mr. Tongue mentions, but I do feel they may be somewhat less effective than they were a year ago, simply because, as several speakers have mentioned, and as I mentioned earlier, more and more industrial capacity is coming in. As the amount of capacity in place increases, competition grows. And this is bound to have at least some restraining effect on the price trend in particular industries.

Representative MILLS. Professor Friend?

Mr. FRIEND. I would agree that without a cut in the budget we are more likely to have price increases than not. I feel they will not be as large as last year.

Though I have said that I think the probability of price rises is greater than the probability of a steady movement or decline, that does not mean I would also say that the danger of inflation is greater than the danger of deflation. If you are in a period such as the present, where we would all agree that the upward momentum in the economy may have disappeared, or at least that you cannot count on it for the next year or two, then I think you have to worry about which is a greater evil, inflation or deflation, and which can be remedied more easily, once it does occur, inflation or deflation?

And I would say in answer to both of these questions that deflation is likely to be the greater evil and the more difficult to remedy.

So I do not think inflation is such a major danger in the current economic situation.

Representative MILLS. Let me then ask whether this combination of circumstances, rising prices, and increased unused capacity, suggests that our efforts to restrain inflation can succeed only at the cost of holding back real activity, at least in the short run?

Mr. FRIEND. I do not think a moderate effort of this sort would have much of an effect in restraining or keeping down real activity.

Representative MILLS. Do you have any suggestions with respect to fiscal policy that might result in preventing further inflationary pressures of the type we have discussed that may occur for the remainder of this year other than the suggestions you have already made?

Mr. FRIEND. I do not think I have anything to add.

Mr. HENLE. I would only like to add one point about the general subject of inflation that we have talked about here:

I think that the newspapers and much of the general discussion have magnified the price rises that we have had, say, over the last year's period, beyond their proper proportion. I think if you look at the price level since the end of World War II, you will reach the conclusion that this country has really done as good a job as could be done of keeping the price level relatively stable.

We have had two major periods of serious price increases; one immediately after the war, caused by the then shortages of goods, and another during the Korean period, when we had extraordinary Federal expenditures. There was a relatively stable price level from about the middle of 1951 to about the middle of 1955. The price level has started to move up more recently. This is something of which we must take note and something about which the Government certainly wants to take action. But I feel that if we look at the problem in longer perspective, we do not come to the conclusion, or at least I personally do not come to the conclusion, that what we have been through is a major inflationary movement.

Mr. TONGUE. Mr. Chairman, would I be permitted to comment on that?

Representative MILLS. Oh, yes.

Mr. TONGUE. I do not know the exact number, as to what the average rate of increase in the price level has been, postwar, but it has certainly been a few percentage points per annum. And I do not look with favor on that continuing indefinitely.

With respect to the change in the price level since the Korean war, I think it is true that a scare-buying situation developed which affected the prices of commodities which are relatively free to move—the farm commodities—and this affected food prices and clothing prices also. So that from 1952 to 1955, while prices for services and finished commodities were rising, prices of food and clothing were declining, reflecting the weakening agricultural situation. This was a happenstance, a unique thing.

As we look to the future we cannot logically expect any such favorable development, and, unless something is done, I believe we face a continued upward creep in the general price level. I do not look upon this prospect with equanimity. I feel that the psychology I mentioned, this ready acceptance of price increases, of a rising trend in the general price level, may continue to spread so that it may become extremely difficult to handle from the standpoint of public policy, to say nothing of the inequities to retired people and others with relatively fixed incomes.

Mr. NEWCOMB. Following the Civil War, prices rose sharply to 1867. Then they went down slowly.

Following World War I they rose sharply to 1920, and then sort of eased down and were lower in 1929, 15 percent lower in 1929 than in 1920.

Following World War II, they shot up again after controls went off in 1947. But unlike World War I and the Civil War, they have continued to rise.

Now, unlike what happened after 1867 and 1920, we have had many, many more years in which prices have gone up, up, up, than years in which prices have dropped. I think, as mentioned, the psychology is quite different now. We expected a stable price level before World War II. Now we are not as sure.

Mr. FRIEND. May I add as a footnote that associated with or following those declines in prices you had major depressions?

Mr. HOADLEY. That is the great threat and end result of inflation.

Mr. NEWCOMB. I referred specifically to experiences such as 1920–29, when we had no depression.

Representative MILLS. Let me see if I can summarize the outlook picture you have presented, in terms of its policy implications, by asking three questions.

First, even though economic buoyancy may have been reduced, there is still enough zip left that, if there were a substantial easing in monetary restraints or tax reduction, inflationary pressures might become substantial?

Mr. HENLE. No. I would not say that.

Mr. HOADLEY. I would agree with that, sir.

Mr. FRIEND. It would depend on how substantial "substantial easing" is.

Representative MILLS. The term "substantial," as I recall, has never been legally defined.

Mr. FRIEND. What I am suggesting is that, unless it is defined, I doubt whether we could take exception to the statement.

Representative MILLS. Would you then agree, defining "substantial" as you care to define it——

Mr. HOADLEY. Inflation is still a threat.

Representative MILLS. Would you agree, Mr. Henle?

Mr. HENLE. I have more reservations, I think, than other members of the panel.

Representative MILLS. Do you think we could reduce taxes without giving rise to greater inflationary pressures at the present time?

Mr. HENLE. I would not favor an immediate heavy tax reduction; but you included also easing of the monetary situation, and I think that that is important in certain fields.

Representative MILLS. In certain areas of our economy?

Mr. HENLE. Yes.

Representative MILLS. Mr. Newcomb?

Mr. NEWCOMB. I think at the moment inflationary pressures are greater than deflationary. But I think that is only a part of the problem. It is directing the flow of funds to where it is needed.

Representative MILLS. You do, however, feel that it would, at the moment, increase inflationary pressures?

Mr. NEWBOMB. Yes.

Mr. FRIEND. With an expenditure reduction of the magnitude that I think is most likely, I would agree with the statement. In other words, I would anticipate, just by reading the newspapers, that an expenditure reduction is likely to be well below $5 billion, and probably under $3 billion, in terms of an effective reduction for fiscal 1958.

But with an expenditure reduction of over $5 billion, as I indicated in my opening remarks, I would disagree with the statement.

Mr. TONGUE. I would agree with the statement, but I would like to add one short but important footnote. I believe it is desirable that consumers should be able to look forward to a decline in taxes in the future when expenditures are reduced, or when rising national income makes possible a reduction.

Representative MILLS. We certainly would not want to do anything to destroy that hope; would we?

Mr. Ulin?

Mr. ULIN. I think it is obvious that a large tax reduction, with continuing high expenditures, or a very rapid easing of credit, would contribute to inflationary pressures.

However, I certainly agree with what Mr. Tongue has just said, that, over a little longer run, our economy should be well able to handle at least some moderate tax reduction.

Mr. HOADLEY. For consumers and business?

Mr. ULIN. Well, I think it was said earlier that an across-the-board reduction is most effective. In general, I would agree with that.

Representative MILLS. The second question I had in mind is: Do you agree that a slight reduction in actual Federal spending in the coming fiscal year, say, $1 to $2 billion, would not significantly change the picture you just described?

Professor Friend has said that. Do you gentlemen agree with Professor Friend?

A substantial reduction in Federal spending would call for some easing in monetary restraints and/or tax reduction, Professor Friend has said.

Do you agree with that conclusion?

Mr. HOADLEY. Yes, sir.

Senator DOUGLAS. By "substantial" would you mean $5 billion?

Representative MILLS. Well, let us speak of it in terms of $3 to $5 billon. Would that justify easing of monetary policy and/or tax reduction?

Mr. HOADLEY. Yes, sir.

Mr. FRIEND. I would have a preference for easing of monetary policy in such a period, because I would still be worried about some inflationary pressure. And once you do reduce taxes, of course, it is difficult to undo it.

Senator DOUGLAS. I want to come back to a point that I developed before, as to just where these inflationary pressures are coming from. Because the figures that I gave about the money supply understate what has been happening. I took the figure of total deposits in currency, as though it covered "demand deposits plus currency outside banks," where, as a matter of fact, it includes not only those two but time deposits as well, which ordinarily would not be regarded as currency.

If you take currency outside banks and demand deposits, which is the best definition of "money," you get a decrease from $138.2 billion in 1955 to $132.6 billion in March of 1957, or a decrease of $5.6 billion, or 4 percent. You get, then, not only an increase in productivity per man-hour but increase in man-hours, and an increase in total physical productivity of probably 5 or 6 percent, and an increase in prices, in wholesale prices, from 110 to 117, or 6 percent, and even if you take into consideration the cost of living, there is an average increase in prices of 5 percent. So one would normally think that, with an increase in physical productivity of 6 percent, there would have to have been an increase of 6 percent in the money supply to balance it so that the price level would be constant; instead of which there is a decrease of 5 percent in the money supply, an increase of 6 percent in physical productivity, and an increase of 6 percent in prices.

Now, money must have worked much harder in those 2 years than before to have increased the velocity to such a degree as to have absorbed this. And this raises the question about the future:

Your discussion has more or less abstracted from Federal Reserve policy. Suppose the Federal Reserve says: "We will not increase the money supply because prices are creeping up." Yet, physical productivity advances. Now, there would certainly have to be an increase in the efficiency of money to keep prices steady in the face of that, that is, to offset the constant money supply. And yet most of you are afraid of inflation. You apparently think that efficiency of corporation treasurers is going to increase faster than physical productivity, so that the quantity of money times the velocity of money will rise faster than the quantity of goods.

Now, suppose the ingenuity of corporation treasurers does not keep pace with all this. Will we not be faced with the possibility that with the fixed money supply and advancing productivity there will be pressure for lower prices, or business will be ground between higher costs and lower prices? Is this fanciful?

Mr. TONGUE. I think under such a circumstance the Federal Reserve policy would be moderated.

Mr. HOADLEY. It would have to be.

Mr. TONGUE. Certainly. But as long as you have what appears to be a relatively low level of unemployment overall in the labor force, and rising prices, I do not see that there is any alternative to present monetary policy. If people do not want to hold as much money as they did before, the Federal Reserve must take action to offset that.

Mr. NEWCOMB. Could we put it this way: that this is a function of the unemployment index and the price level? And if you got certain ideas as to that, you can forecast the public reserve policy and know what is going to happen?

Senator DOUGLAS. No; I did not say that.

Mr. TONGUE. Senator, if there is a real question between the price level and employment, there is no question as to which way we would have to decide. We cannot afford to run the risk of projecting a widescale depression, with the thought that it might do something about the price trend. On the other hand, I do think that responsible policy requires that the present upward creep be resisted so long as there is evidence that that is not injuring the overall level of employment and output of the country.

Mr. HOADLEY. Senator, I think the crucial point here is, as always, the matter of timing of change in economic policy. Certainly the conditions which you describe would suggest that everyone should be alert to the possibility of economic distress; but it is a matter of opinion as to just when a change in policy should be made. As I detect the general feeling here, no one is saying that the money supply should be held rigidly for an indefinite period of time.

Senator DOUGLAS. As a matter of fact, as I have pointed out, it has actually been reduced by 4 percent in the last 2 years, in the face of advancing productivity, and still prices have gone up.

Mr. HOADLEY. So long as prices, and especially the cost of living, are rising, I for one would feel that inflation is the problem and fiscal monetary policy should be geared accordingly. Those in responsible fiscal and monetary policy positions, however, should be constantly alert to changing economic trends and developments.

I am just saying that the time to relax current fiscal and monetary policies is not right now.

Mr. FRIEND. Our reaction implies that none of us here around the panel table is a quantity theorist, at least in the short run.

Senator DOUGLAS. Why should you be ashamed of being a quantity theorist?

Mr. TONGUE. Do not misunderstand us. I do not think any of us would quarrel with the equation that MV equals PT. We might have a little different idea as to how the process works, and we do not automatically assume that changes in money or velocity will affect anything, without further analysis.

(The memorandum prepared by the Joint Economic Committee staff on the economic situation and outlook is as follows:)

MEMORANDUM TO THE MEMBERS OF THE JOINT ECONOMIC COMMITTEE FROM GROVER W. ENSLEY, EXECUTIVE DIRECTOR, THE ECONOMIC SITUATION AND OUTLOOK, MAY 23, 1957

Attached is a summary of the economic situation and outlook for 1957, prepared by the committee staff on the basis of extensive discussions with technicians in the executive agencies of the Federal Government, and economists in business, universities, and research organizations.

This summary is consstent with the moderately optimistic picture presented by the committee staff last November, and more recently, in February, in connection with the committee's consideration of the President's Economic Report. A gross national product of about $435 billion still seems likely this year. The misgivings with respect to the immediate economic outlook, which prevailed in many quarters early in the year, now have noticeably lessened.

THE ECONOMIC SITUATION AND OUTLOOK

SUMMARY

Final purchases by consumers, business, and government have continued to rise in 1957 as rapidly as during 1956 (chart I). Final purchases include all of gross national product except inventory changes. Significantly, real final demand has increased after allowing for rising prices (chart II). Total output in constant prices, however, has increased little since the fourth quarter of 1956. This leveling out of production despite increasing demand is accounted for by rising prices and the recent shift from substantial inventory accumulation to mild liquidation.

Economic indicators point toward a continued rise in final purchases of goods and services. Business plans to purchase plant and equipment somewhat above the first quarter rate. Housing activity appears to be near the end of the decline which began in 1955. Consumer spending continues to increase, stimulated by rising incomes and population growth. Increases in total government purchases of goods and services (Federal, State and local) have accounted for a substantial part of the rise in total final purchases since mid-1956 and are expected to continue to do so during the remainder of 1957.

Prices of raw and intermediate products seem to have leveled out, at least temporarily. Prices of finished products, however, are expected to continue to rise.

The trend of total real output in coming months will depend largely on inventory movements. Recent changes appear to be selective adjustments of inventories to particular supply and price situations rather than a general response to disappointing sales. In the aggregate, present inventory-sales ratios are not excessive by historical standards. In view of rising trends in incomes, final purchases, and prices of finished goods, prolonged inventory liquidation seems unlikely. An upturn in real output would result as soon as such liquidation ends.

The economic situation at the end of 1957 and immediately beyond is less clear. This is usual so many months in advance, even though confidence in longer run prospects is warranted. Temporary letdowns in demand for housing, for business plant and equipment, or for consumer durable goods are not precluded by favorable long-term expectations.

The committee has repeatedly stated that monetary and fiscal policies should give due consideration to economic conditions and prospects. The hearings on fiscal policy implications of the economic outlook and budget developments, scheduled by the Subcommittee on Fiscal Policy for June 3–7 and 13–14, will consider the application of this principle in current circumstances.

TOTAL OUTPUT AND EMPLOYMENT

(1) Gross national product, according to preliminary estimates, rose $3.3 billion, from $423.8 billion in the fourth quarter 1956 to a first quarter 1957 annual rate of $427.1 billion. Rising prices account for almost half of this increase.

(2) While real output changed very little, total purchases of goods and services, exclusive of inventory, continued to expand in real terms in the first quarter as in preceding quarters. These divergent movements resulted from a shift from inventory accumulation at a seasonally adjusted annual rate of about $4.1 billion during the fourth quarter of 1956 to liquidation at an annual rate of $1.2 billion in the first quarter of 1957.

(3) The index of industrial production averaged 146 in the first quarter—about the same as the preceding quarter. In April the index declined 1 point to 145.

(4) Changes in employment and unemployment have represented mainly seasonal movements since December. A small decrease in manufacturing employment has been offset by increases elsewhere. Unemployment (new definitions) in April was 2.7 million, or 4 percent of the civilian labor force—about the same as the same month of 1956. In March 1957 there were 19 major areas of substantial labor surplus, the same as in March 1956.

(5) Total man-hours worked in manufacturing have tended to move down moderately in recent months (allowing for usual seasonal changes), as a result of declines in both hours of work and employment. Since output has been stable, output per man-hour probably has been increasing.

BUSINESS INVESTMENT

The March Commerce-Securities and Exchange Commission survey of business expenditures on plant and equipment shows 1957 plans for outlays about 6.5 percent above those of 1956. About one-half of this rise may be attributable to higher prices. A plateau is indicated for the year, a little above the first quarter record rate of such purchases.

The survey reveals a greater diversity in plans for this year than was true a year ago when all industry groups were scheduling expanding programs. It also shows that large- and medium-sized firms account for the anticipated rise in manufacturing investment in 1957, while small companies, in the aggregate, plan a reduction in outlays.

The Commerce-SEC survey is consistent with the 12-percent increase shown by the McGraw-Hill survey, published April 26. The different rates of increase shown by the two surveys result from McGraw-Hill's coverage of only large firms while Commerce-SEC covers small- and medium-sized firms as well.

The latest survey of business capital appropriations by the National Industrial Conference Board appears in the May 27 issue of Newsweek. According to this survey, the second half capital expenditures will be slightly higher than the first half—the same trend assumed on the basis of the other surveys.

Business plans to maintain a high level of capital expenditures during the next 4 years, according to the recent McGraw-Hill survey. Manufacturing companies in this survey reported a 6-percent increase in manufacturing capacity in 1956. They plan another 6-percent increase in 1957 and a further 15-percent increase during the following 3 years. Manufacturing companies were reported to be operating at 86 percent of capacity at the end of 1956, somewhat below their preferred rate of 90 percent.

As expected, a decline in private residential (nonfarm) construction has been offset by rises in other private construction. Considering the increases in construction costs over the last year, total private construction outlays in real terms during the first 4 months of 1957 have been below a year ago. Housing starts (seasonably adjusted) rose slightly in April. Contract awards have been rising more than seasonally.

SALES, INVENTORIES, AND NEW ORDERS

(1) Total business sales have declined slightly from a peak reached in January (seasonally adjusted), but movements have been small, reflecting, in part, reduction in purchases for inventory.

(2) Inventories declined in the first quarter at an annual rate of $1.2 billion, measured in average prices prevailing during the quarter, compared to an accumulation of $4.1 billion, annual rate, in the fourth quarter of 1956. In terms of book values which reflect rising prices as well as volume changes, business inventories increased slightly during the quarter as manufacturing inventories rose and those of trade firms declined.

(3) New orders placed with manufacturers during March totaled $27.8 billion on a seasonally adjusted basis. This represented an increase of 3 percent over March 1956 but a decline of about 5 percent from November 1956. The recent decrease has centered in the durable-goods industries. Shipments have equaled or slightly exceeded the flow of new business in manufacturing recently so that backlogs of unfilled orders declined fractionally. At the end of March, however, backlogs of unfilled orders were still $4 billion above those of a year earlier. In the machinery industries backlogs are equal to 5 or 6 months' output at current rates. The decline in new orders reflects both inventory adjustments and a slowing rate of increase in investment in plant and equipment. In the aggregate, present inventory-sales ratios are not excessive by historic standards. In view of increases in incomes, in final purchases, and in prices of finished goods, therefore, prolonged inventory liquidation seems unlikely.

INCOME

Personal income reached $336.5 billion (seasonally adjusted annual rate) in the first quarter, an increase of about 1 percent over the fourth quarter of 1956 and almost 6 percent above the first quarter of last year. In April, personal income rose to $339.3 billion, or almost 1 percent above the first quarter average. After taxes, disposable personal income was $295.4 billion in the first quarter compared to $280.2 billion in the same quarter a year ago. After adjusting for price change, total real disposable personal income was about 2 percent higher than in the first quarter of 1956 but per capital real disposable personal income was about the same in the first quarter as during 1956.

(1) Increases in total wages and salaries in current dollars reflect sustained high levels of employment and a rise in wage rates sufficient to offset shorter hours of work. Average hourly earnings have increased 5 percent over the past year. The workweek declined almost one-half hour.

The purchasing power of spendable weekly earnings of the average factory worker (weekly earnings after deduction of Federal income and social-security taxes, adjusted for price changes), however, did not gain over the past year for the first time since mid-1954. Income taxes took a slightly larger share of wages. Consumer prices rose 3.7 percent. The rate of social-security deductions increased.

(2) According to BLS data, about 1,400,0000 workers will soon receive escalation wage increases as a result of recent rises in consumer prices. At least 5 million workers will receive wage increases sometime during 1957 on the basis of contracts concluded in 1955 and 1956.

(3) According to preliminary estimates, first quarter corporate profits, after adjustment for usual seasonal changes, were about the same as in the fourth quarter of 1956, and about 6 to 7 percent above the first quarter of last year. For the year 1957, profits before taxes are likely to average at least as high as the first-quarter level.

(4) Farmers' realized net income is estimated at a seasonally adjusted annual rate of about $12 billion in the first quarter, compared to $11.6 billion a year earlier. According to the Agricultural Marketing Service of the Department of Agriculture, a further increase in farm operators' realized net income in 1957 seems likely, perhaps as much as the 4-percent increase that occurred in 1956.

CONSUMPTION

(1) Personal consumption expenditures, under the stimulus of higher incomes and population growth, advanced $4.1 billion to a new record rate of $275 billion in the first quarter, rising slightly faster than disposable income. The rate of personal savings declined to 6.9 percent of disposable income in the first quarter of 1957, although it was at a rate slightly higher than the same quarter of 1956. From the fourth quarter to the first quarter, durable-goods purchases rose about $1.1 billion, nondurable goods $1.7 billion, and services $1.3 billion.

(2) Preliminary findings of the 12th annual survey of consumer finances confirm earlier indications that consumers, with financial positions improved during 1956, continue to be optimistic about the future.

INTERNATIONAL

Net foreign investment increased during the first quarter to a seasonally adjusted annual rate of $4 billion. The average for 1956 was $1.4 billion. The high first-quarter rate reflects effects of the Suez crisis; succeeding quarters may be expected to show more modest figures.

There are further indications of renewed economic expansion in Western Europe during the first quarter of 1957. Output advanced in these months in such countries as Germany, France, Sweden, and the Netherlands, and remained unchanged in Great Britain.

PRICES

Consumer prices have continued to rise. March was about 2.3 percent above the average of 1956 and 3.7 percent above March 1956.

The rise in the wholesale price index has slowed. Prices of raw materials have declined slightly, prices of intermediate products have been stable, and prices of finished consumer and producer products continue to rise.

Construction costs have also continued to rise, though a little more slowly than the 5-percent annual rate prevailing during most of 1956. Recently, transportation rates were increased. There is widespread discussion of a steel-price hike by midyear.

STATE AND LOCAL GOVERNMENT EXPENDITURES

State and local governments purchased goods and services in the first quarter at an annual rate of $35 billion, an increase of $1.3 billion over the rate in the fourth quarter of 1956 and $2.9 billion over the first quarter a year ago. The current rate is above earlier expectations.

FEDERAL FISCAL DEVELOPMENTS

Reports through April suggest that the administrative budget will show a surplus of about $1 billion for this fiscal year, ending June 30, 1957. For fiscal 1958, the administrative budget surplus seems likely to fall within the range of $1 billion to $2 billion. Estimates by the staff of the Joint Committee on Internal Revenue Taxation do not differ materially from these.

(1) Receipts are running slightly ahead of the estimates for fiscal 1957 in the President's January 1957 budget. On the basis of present economic trends, receipts may exceed the January estimates for fiscal 1958 by about a billion dollars.

(2) Budget expenditures for the fiscal years 1957 and 1958 may exceed the January estimates by $1 billion to $1.5 billion in each year. This reflects higher prices than assumed in the January budget estimates. Government purchases are largely concentrated among goods and services for which private demand has been and continues to be heavy.

(3) The long lead times between appropriations and expenditures suggest that reductions in appropriations now probably would not reduce expenditures significantly before fiscal 1959. Total new and old (unspent from previous years) obligational authority available for expenditure in fiscal 1958 was estimated at $143.3 billion in the January budget. Of this total, it was anticipated that nearly half, or $70 billion, would be unspent balances carried forward from 1957 and prior fiscal years.

MONETARY DEVELOPMENTS

(1) Apart from meeting week-to-week and seasonal needs, the Federal Reserve System, acting on its own initiative through the open-market operations, has supplied no additional reserves to the banking system during the past year or, indeed, for the past 2 years. Government security holdings of the Reserve System at $23,169 million on May 1, 1957, were, for all analytical purposes, unchanged from a year ago. They averaged about $400 million less during April 1957 than in April 1955.

(2) While, in contrast to the preceding year, member bank borrowings for reserves tended to decline somewhat during late 1956, by April 1957 member banks as a group continued to be net borrowers at roughly the same rate as a year ago. What for several months gave an appearance of a growing trend to return to a position of balance or modest excess reserves seems to have been reversed in January 1957 with an increased willingness to borrow for reserves and a return to a deficiency reserve position level of some $300 million to $600 million.

(3) On the other hand, loans adjusted at weekly reporting member banks in leading cities declined about $700 million in the first 4 months of this year compared to an increase of almost twice that amount in the corresponding period last year.

(4) It is yet too early to tell whether the lessened demand for business loans this spring is a precursor to generally easier credit and a softening of interest rates. The tight bank reserve position inherited from an expansion of 33½ percent in bank loans in the 2 years 1955 and 1956 tends to prevent any immediate easing of interest rates. Under present policies, whether there is to be any relaxation in the terms and price of money in the months ahead will depend upon the trend in the demands of business for inventory and capital expenditures and the demand for home-building funds.

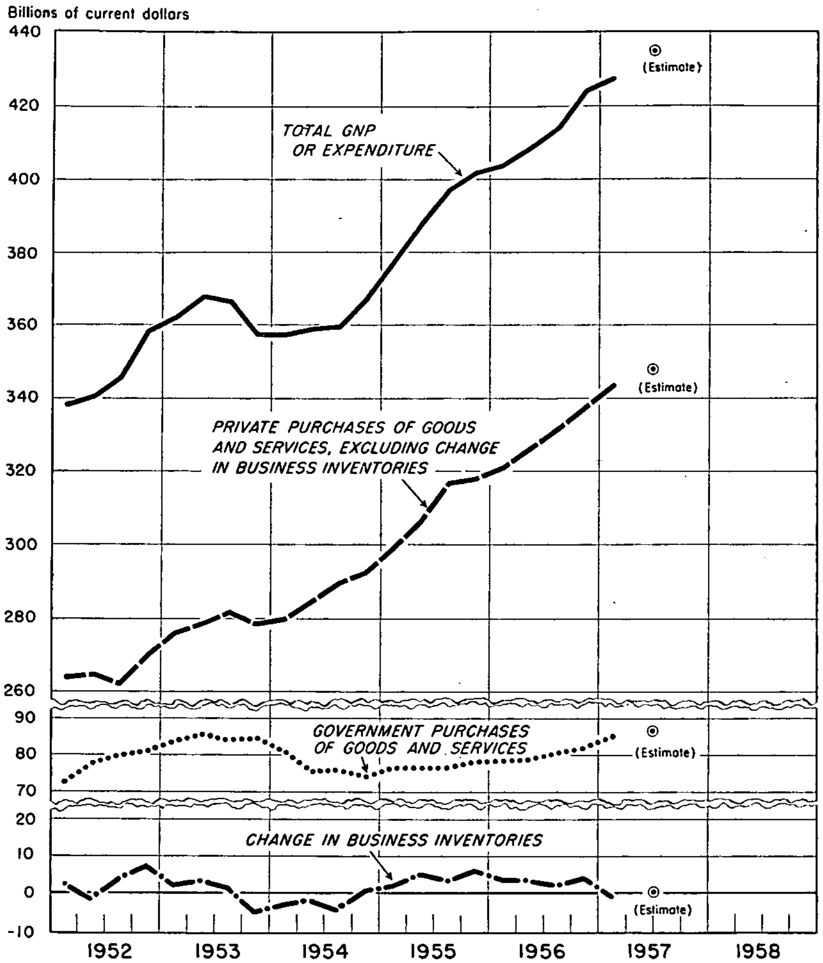
(5) With the recurrent need to raise new money to meet expenditures, to cover attrition on refunding issues, and the redemption of E-, F-, and G-bonds, the Treasury Department has thus far found little respite from the tight money pressures. Some modest softening has developed in the Treasury bill rate. In the recent refunding, carrying a May 1 date, however, the Treasury offered a certificate with a rate of 3½ percent. This is the highest rate paid by the Treasury on such paper since 1933. Similarly, the 3⅝ percent rate on the 4¾-year note in the same offer is the highest rate offered by the Treasury since 1923 for a note carrying a term of 4 to 5 years.

(6) While maturities in August total $15.8 billion and those in October $8.1 billion, $15 billion of these are held by the Federal Reserve and Government accounts. In addition to maturing weekly bills, the Treasury will thus have the problem of refunding about $9 billion of publicly held debt and the raising of perhaps an additional $5 billion to $6 billion of seasonal new money before the end of the year.

CHART I

GROSS NATIONAL PRODUCT OR EXPENDITURE

QUARTERLY 1952-'57

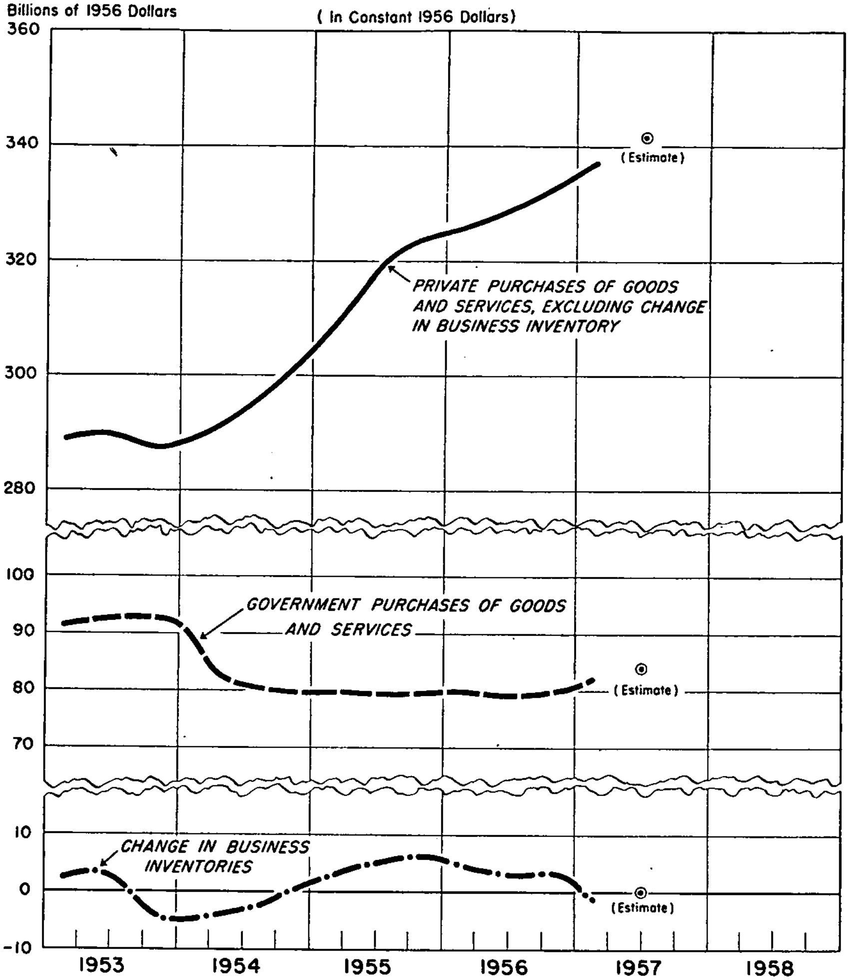


Source: Department of Commerce, Office of Business Economics.
1957 Estimate Staff, Joint Economic Committee.

CHART II

GROSS NATIONAL PRODUCT OR EXPENDITURE

QUARTERLY 1953-'57



Source: Staff, Joint Economic Committee.

TABLE 1.—*Gross national product or expenditures, quarterly, 1952–57*

[Billions of current dollars]

Period	Purchases of gross national product			Change in business inventories	Purchases of gross national product excluding change in business inventories	
	Total	Government	Private		Total	Private
1952						
1st quarter	338.4	72.2	266.2	2.7	335.7	263.5
2d quarter	340.1	77.4	262.7	−1.9	342.0	264.6
3d quarter	345.2	79.8	265.4	3.7	341.5	261.7
4th quarter	358.1	80.5	277.6	7.4	350.7	270.2
1953						
1st quarter	361.6	83.6	278.0	2.0	359.6	276.0
2d quarter	367.4	85.5	281.9	3.1	364.3	278.8
3d quarter	366.3	83.8	282.5	1.1	365.2	281.4
4th quarter	357.5	84.5	273.0	−5.2	362.7	278.2
1954						
1st quarter	357.6	80.8	276.8	−3.1	360.7	279.9
2d quarter	358.5	75.5	283.0	−1.7	360.2	284.7
3d quarter	359.4	75.6	283.8	−4.5	363.9	289.3
4th quarter	367.1	74.2	292.9	.2	366.9	292.7
1955						
1st quarter	377.3	76.3	301.0	1.9	375.4	299.1
2d quarter	387.4	76.2	311.2	4.9	382.5	306.3
3d quarter	396.8	76.5	320.3	3.7	393.1	316.6
4th quarter	401.9	78.1	323.8	6.1	395.8	317.7
1956						
1st quarter	403.4	78.5	324.9	4.1	399.3	320.8
2d quarter	408.3	78.7	329.6	3.5	404.8	326.1
3d quarter	413.8	80.2	333.6	2.0	411.8	331.6
4th quarter	423.8	82.0	341.8	4.1	419.7	337.7
1957: 1st quarter	427.1	84.9	342.2	−1.2	428.3	343.4
1957 calendar year [1]	435.0	87.0	348.0	0	435.0	348.0

[1] Estimate, staff, Joint Economic Committee.

Source: Department of Commerce, Office of Business Economics, except as noted.

Representative MILLS. Gentlemen, we greatly appreciate the contribution you have made to our study today on the economic outlook. The subcommittee adjourns until tomorrow morning at 10 o'clock in the same room, G–16.

(Whereupon, at 12:20 p. m., the hearing was adjourned until 10 a. m., Tuesday, June 4, 1956.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

TUESDAY, JUNE 4, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to adjournment, in room G-16, the Capitol, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Senator Douglas.

Representatives Mills (chairman of the subcommittee) and Curtis.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy, and John W. Lehman, acting executive director.

Representative MILLS. The subcommittee will come to order.

This is the second day of the hearings by the Subcommittee on Fiscal Policy on Implications of the Economic Outlook and Budget Developments.

As I indicated yesterday, the purpose of these hearings is to bring into clear perspective the economic considerations and budget facts which must go into responsible fiscal policy decisions.

Yesterday a panel of distinguished economists discussed for us the economic outlook for the remainder of this year and 1958. Today another eminent group of economists will focus on the effects of appropriation actions so far this year on actual Federal spending in fiscal 1958 and on the types of fiscal and monetary action which these developments would call for in the interests of economic growth and stability.

We will hear the opening statement of each panelist before proceeding with the general discussion.

Our first witness is Dr. Gerhard Colm, chief economist of the National Planning Association.

Dr. Colm, it is a pleasure to have you with us this morning, and you are recognized.

STATEMENT OF GERHARD COLM, CHIEF ECONOMIST, NATIONAL PLANNING ASSOCIATION, WASHINGTON, D. C.

Mr. COLM. Thank you, Mr. Chairman.

You have before you my prepared statement, and also, appended to it, a statement on the revised budget outlook, which I prepared with the help of my associate, Manuel Helzner. I also had the benefit of cooperation from the Budget Bureau, which made certain work sheets available to me. However, the estimates are entirely our own responsibility.

The table on page 2 of my prepared testimony, Mr. Chairman, gives you the upshot of my study. For fiscal year 1958 under our revised estimate, the President's $71.8 billion budget estimate of last January may go to $72.8 billion under current programs. This assumes that the Congress will enact the proposed increase in postal rates. If Congress should fail to act on that, then, under present policies, expenditures in fiscal 1958 might total $73.5 billion. This result may appear shocking if contrasted with the great efforts made by the legislative and executive branches to reduce expenditures.

I have indicated this result in some detail in the table which appears at the bottom of page 2 and the top of page 3. We believe, on the basis of recent trends in Government expenditures, that the President's general budget estimate for 1958 was underestimated by roughly $1.9 billion, most of which was in the Defense Department. This is attributable mainly to higher costs but also to some speedup in certain procurement programs.

Our revised estimate then begins $1.9 billion higher than the original budget estimate. Next we assume that the impact of the reduction in appropriation requests will lower that figure by $1.6 billion. This figure we think is the impact on expenditures of the reductions in appropriations. That reduction, however, will in part be offset by new legislation. And here we are contemplating only such legislation as has passed either 1 of the 2 Houses. We are not considering other pending legislation. This gives us an addition of $400 million, particularly for housing and veterans legislation.

Then we estimate that there will be requests for supplemental appropriations, which will have an effect on 1958 spending. This situation is again particularly the case with regard to the veterans program, where the reduction in appropriations was made simply by changing the estimate of the Government agency. We, therefore, add $300 million for possible supplementals. That gives us a budget estimate of $72.8 billion for fiscal 1958 or if we assume that no action will be taken on the postal rate, $73.5 billion.

I do not want to say that 1958 budget expenditures are absolutely determined and beyond control. It is still possible that Congress will act on the increase in postal rates. And it is also not impossible that executive action, such as a reduction in the number of the Armed Forces, may reduce the increase in expenditures. In addition, measures might be adopted to modify expenditures in a particular year by such devices as the issuance of certificates of interest, instead of drawing on Treasury funds for financing the farm support program, as has been done in the past. Nevertheless, it appears reasonable to conclude that at least no substantial increase in the surplus, either in the administrative or cash budget, can be expected for the fiscal year 1958.

The guess for the fiscal year 1959 is, of course, much more tentative. It indicates that we could expect an increase in expenditures almost equal to the increase in revenue which we would obtain if favorable business conditions should be maintained through that period.

The guess for the year 1959 assumes that expenditures for national security and nondefense areas will be continued under present policies. It also assumes that the rise in procurement costs will continue at a moderate scale.

This budget outlook may give the impression that the Congress has perhaps not cut the budget sharply enough; because the trend of rising expenditures has not been reversed. I would not draw that conclusion. The trend of rising expenditures results basically from causes which are not under the control of the budget makers, either in the executive or the legislative branch. Nor could this trend be reversed simply by adopting a different system of accounting, as has been suggested, for instance, by the Hoover Commission.

The rising trend in expenditures primarily reflects the increased responsibilities which the United States has had to assume in this chaotic world. It is the policy of the Government to develop and maintain offensive and defensive weapons which, together with the forces of our allies make it clear that any attack on the United States or her allies would be a suicidal gamble. In addition, it is the policy of the United States to stand ready to prevent or effectively counteract localized ventures of the Soviet bloc in various parts of the world.

These policies require that we provide our Armed Forces with improved conventional equipment and at the same time participate in a race for the development of not only more advanced offensive weapons but also more effective defense measures against these advanced weapons. The costs of production in these areas have risen most severely and are likely to rise more.

Great Britain was able to reduce her defense expenditures somewhat because she placed increased reliance on United States technological developments. We could not do the same without a fundamental revision in the strategy of the free world. I am not competent to judge whether there is at present any realistic possibility of limiting the international technological armaments race. In my opinion, a limitation of the armaments race—with or without international agreement—would be the only event which could reverse the trend of rising Government expenditures. As much as I hope that such limitation will become possible, I would be fearful if the Government should lessen needed national security efforts solely in order to permit a reduction in expenditures and taxes.

In the nondefense fields a continued increase in expenditures will follow by necessity from present legislation. Furthermore, I do not believe that present programs are adequate for giving needed support to economic and social development. The National Planning Association just this year issued a Joint Statement on National Investment for Economic Growth signed by many leaders in agriculture, business, labor, and the professions. This statement not only emphasized the need for economy in government and the desirability of tax reduction, but also stated that adequate defense and nondefense programs should have higher priority than tax reduction.

The fact that we can expect only a small surplus in the administrative and cash budgets should not, in itself, make a moderate tax reduction impossible. Indeed, I would see nothing basically wrong if the Federal Government financed some of its outlays by borrowing, similarly as State and local governments or business enterprises do. I would, however, recommend such a policy only if it were necessary in order to promote a better balance in the economy as a whole. Therefore, I fully concur with the plan of this committee to consider tax and debt policy in the light not only of the budget outlook but also of the economic outlook.

Mr. Chairman, I have in my prepared testimony a brief summary of the economic outlook, which I will omit reading, because it was discussed yesterday. I wrote it before I had the benefit of yesterday's discussion. I find myself in accord with the experts.

From the economic outlook as presented yesterday, different conclusions as to fiscal policy have been drawn by various observers. Stating only the extremes, we find on the one hand those who say that because of the upward movement in prices a continued restrictive fiscal policy is warranted. This would include continued if not greater credit restraint and postponement of tax reduction.

On the other hand, some maintain that because the increase in economic activity has been slowing down, if not halted, credit relaxation and tax reduction should be adopted now to give needed support to economic expansion.

I find some merit and some faults in both these views.

Again, Mr. Chairman, I have in my prepared testimony a more detailed discussion of these two views. I pass over it at this time and come to my own conclusions.

I do not think that we should adopt tax reduction and credit relaxation at the present time unless a severe slack threatens in the economy. Nor would I recommend immediate tax reduction or a legislative commitment for substantial tax reduction in the near future unless a limitation in the armaments race appears as a realistic possibility and unless our defense strategy can be basically revised. This argument against early and substantial tax reduction is, of course, no argument against tax revision.

To promote economic expansion, I would recommend as a first step credit relaxation and would favor measures which would give increased financial support to residential construction and community development. Such a credit policy would have its greatest impact on those specific activities which have suffered most. Tax reduction would have a much more general effect and would have to be substantial before it could have an impact on such areas as residential construction or depressed areas. Relaxing credit first also has the advantage that it is more easily reversible than tax reduction and therefore more suitable in a still very cloudy international situation.

At the same time, I would urge that the problem of the price and cost push be studied for the purpose of developing an effective policy of price stabilization. Only when such stabilization policies have been developed will it be possible to make fuller use of fiscal and credit policies in support of economic growth. Until we have proper devices for dealing with the price and cost push, we should not throw away the fiscal brakes, crude as they are. We should use them, however, gently and should recognize that if used too hard they may do more harm than good.

If the rise in national security expenditures could be held at the $45 billion level, or if these expenditures could be reduced, substantial tax reduction would not only be feasible but, in my opinion, become an economic necessity in future years.

I believe it is premature to adopt such tax reduction now. Nevertheless, it is not too early to prepare for tax reduction now for adoption when the budgetary situation permits it and when the economic situation requires it.

I am glad to know that this subcommittee will consider this problem in subsequent hearings.

Thank you very much.

Representative MILLS. Dr. Colm, you will have the privilege, of course, of inserting your entire statement in the record.

(The statement referred to is as follows:)

STATEMENT OF GERHARD COLM, NATIONAL PLANNING ASSOCIATION, BEFORE THE SUBCOMMITTEE ON FISCAL POLICY OF THE JOINT ECONOMIC COMMITTEE, JUNE 4, 1957

My name is Gerhard Colm. I am chief economist of the National Planning Association, which is a nonprofit, nonpolitical organization. I am appearing, however, as an individual, rather than as a representative of my organization. I appreciate the invitation of the chairman to participate in this panel today, because it comes at a time when the Government is faced with important decisions which will affect economic conditions in 1958 and later years.

THE BUDGET OUTLOOK FOR THE FISCAL YEARS 1958 AND 1959

I have been asked specifically to evaluate the likely impact of current congressional and executive policies on the budget outlook. Since the Congress has not yet completed consideration of all pending appropriation requests and relevant legislation, only guesses can be made at this time. In the statement attached to this testimony, my associate, Manuel Helzner, and I present such guesses for the fiscal years 1958 and 1959. I would like, at this point, to express my appreciation to the Budget Bureau for making available to us information on current appropriations and expenditures. As for the conclusions, however, we take sole responsibility.

It is our conclusion that both spending and revenue in the fiscal year 1958 will probably turn out to be somewhat higher than estimated last January in the President's budget. The increase in spending will probably exceed the increase in revenues so that the expected budget surplus would be somewhat smaller than estimated in January, and smaller than the surplus which was realized in the fiscal year 1956, especially if no action should be taken on the proposed increase in postal rates.

Federal budget outlook, fiscal years 1956–59

Fiscal year	Administrative budget (Billions of dollars)			Consolidated cash budget (Billions of dollars)		
	Receipts	Expenditures	Surplus	Receipts	Expenditures	Surplus
1956 (actual)	68.1	66.5	+1.6	77.1	72.6	+4.5
1957 (revised estimate)	70.7	69.8	+.9	82.0	80.0	+2.0
1958 (revised estimate)	73.8	72.8	+1.0	87.0	84.5	+2.5
1959 (tentative guess)	76.8	75.3	+1.5	90.8	88.5	+2.3

NOTE.—For assumptions and explanation, see statement attached.

This result may appear shocking if contrasted with the efforts made by the legislative and executive branches to reduce expenditures. It should not come as a surprise to those who read the recent staff report of the Joint Committee on Internal Revenue Taxation, which reached essentially the same conclusion.

Our estimates are explained more fully in the attached statement. I will only summarize the main items which show the results in terms of the administrative budget:

	Estimate of expenditures (billions of dollars)
For the fiscal year 1958:	
In President's January budget message	71.8
Probable underestimate in President's budget (principally national security)	+1.9
Impact of reductions in appropriation requests	−1.6
Impact of housing legislation	+ .2
Impact of other pending legislation	+ .2
Possible impact of supplemental and deficiency appropriations	+ .3
Revised budget outlook for fiscal year 1958	72.8
Impact of failure to increase postal rates	+ .7
Revised budget outlook for fiscal 1958 without postal rate increase	73.5

This is not to say that the estimated level of expenditures suggested here is certain or entirely without control. It is still possible that the Congress will act on the increase in postal rates. It is also not impossible that executive action, such as a reduction in the number of the Armed Forces, may reduce the increase in expenditures. In addition, measures might be adopted to modify expenditures in a particular year by such devices as the issuance of certificates of interest instead of drawing on Treasury funds for financing the farm price support program. The estimates which I have presented are based primarily on a consideration of budget prospects as of last week and do not presuppose these possibilities. Nevertheless, it appears reasonable to conclude that at least no substantial increase in the surplus either in the administrative or cash budget can be expected for the fiscal year 1958.

The "tentative guess" for the fiscal year 1959 indicates a continuing increase in expenditures almost equal with the increase in revenues which would be expected if favorable business conditions should be maintained. The guess for the year 1959 assumes that expenditures for national security and nondefense areas will be continued under current legislation and present policies. It also assumes some further rise in procurement costs.

This budget outlook may give the impression that the Congress has perhaps not cut the budget sharply enough because the trend of rising expenditures has not yet been reversed. I would not draw that conclusion. The trend of rising expenditures results basically from causes which are not under the control of the budget makers, either in the executive or the legislative branch. Nor could this trend be reversed simply by adopting a different system of accounting, as has been suggested.

Rather, the rising trend in expenditures primarily reflects the increased responsibilities which the United States has had to assume in this chaotic world. It is the policy of the Government to develop and maintain offensive and defensive weapons which, together with the forces of our allies, make it clear that any attack on the United States or her allies would be a suicidal gamble. In addition, it is the policy of the United States to stand ready to prevent or effectively counteract localized ventures of the Soviet bloc in various parts of the world.

These policies require that we provide our Armed Forces with conventional equipment and at the same time participate in a race for the development of not only more advanced offensive weapons but also more effective defensive measures against these advanced weapons. The costs of production in these areas have risen most severely.

Great Britain was able to reduce her defense expenditures somewhat because she placed increased reliance on United States technological developments. We could not do the same without a fundamental revision in the strategy of the free world. I am not competent to judge whether there is at present any realistic possibility of limiting the international technological armaments race. A limitation of the armaments race—with or without international agreement—would be the only event which could reverse the trend of rising Government expenditures. As much as I hope that such limitations will become possible, I would be fearful if the Government should lessen needed national security efforts solely in order to permit a reduction in expenditures and taxes.

In the nondefense fields a continued increase in expenditures will follow by necessity from present legislation. Furthermore, I do not believe that present programs are adequate for giving needed support to economic and social development. The National Planning Association just this year issued a joint statement on national investment for economic growth signed by many leaders in agriculture, business, labor, and the professions. This statement not only emphasized the need for economy in Government and the desirability of tax reduction, but also stated that adequate defense and nondefense programs should have higher priority than tax reduction.

The fact that we can expect only a small surplus in the administrative and cash budgets should not, in itself, make a moderate tax reduction impossible. Indeed, I would see nothing basically wrong if the Federal Government financed some of its outlays by borrowing, similarly as State and local governments or business enterprises do. I would, however, recommend such a policy only if it were necessary in order to promote a better balance in the economy as a whole. Therefore, I fully concur with the plan of this committee to consider tax and debt policy in the light not only of the budget outlook but also of the economic outlook.

THE ECONOMIC OUTLOOK

An appraisal of the economic outlook has been assigned to another panel. Therefore, I will only summarize my views as a basis for fiscal policy conclusions. The rate of increase in economic activity—in real terms—has been leveling off over the last year. Many observers expect a modest upturn later in the year with the result that the fourth quarter 1957 may show a level of activity above that of the fourth quarter of the preceding year—again excluding the effect of price increases. However, the increase in activity is less than the rise in the labor force, the expansion in plant and equipment and the advances in technology would permit. We are likely to move along at somewhat below the maximum level of employment and production. At the same time, it is expected that prices will continue to rise although probably at a reduced rate.

FISCAL POLICY CONCLUSIONS

Different conclusions have been drawn by various observers from this economic outlook. Stating only the extremes, we find, on the one hand, those who say that because of the upward movement in prices, a continued restrictive fiscal policy is warranted. This would include continued, if not greater, credit restraint and postponement of tax reduction. On the other hand, some maintain that because the increase in economic activity has been slowing down, if not halted, credit relaxation and tax reduction should be adopted now to give needed support to economic expansion.

I find some merit and some faults in both these views. With respect to the first position, I feel it is necessary to analyze the reasons for the price rise. Price increases resulting from an expansion of demand which presses against scarce resources can most effectively be counteracted by restrictive tax and credit policies. However, it appears that the economy has been expanding at a lesser rate than resources permit. This suggests that the price rise must be attributed, at least in part, to other causes than generally excessive demand. I shall not enter here into the controversy as to whether price increases in industries which may not be fully competitive or whether the rise in labor costs have contributed most to the result. Nor do I wish to raise the question as to what is cause and what is effect in the price-wage spiral. However, if it is true that excessive overall demand is not the primary cause of the price rise, then additional demand restrictions may lead to a further slowdown in the rate of growth and to an increase in unemployment. A continued restrictive policy alone cannot be the full answer to our economic problem.

In spite of this I cannot recommend loosening all the fiscal brakes at the same time. This leads me to a criticism of the second position to which I referred.

Overall demand has not been seriously deficient. I would agree that the recent inflation has originated primarily in a price and cost push rather than in excessive demand. Nevertheless, monetary demand has continued to rise. Otherwise, the increase in prices and the credit restraint would have caused a general decline in economic activity and more widespread unemployment.

The restrictive credit policy has resulted primarily in declines in activities which are particularly dependent on credit, such as residential construction and certain industries in which small business are dominant. Therefore, I am not convinced that immediate and simultaneous tax reduction and credit relaxation are called for.

93528—57——5

My conclusions from these critical considerations would be the following: I do not think that we should adopt tax reduction and credit relaxation at the same time unless a severe slack threatens in the economy. Nor would I recommend immediate tax reduction or a legislative commitment for substantial tax reduction in the near future unless a limitation in the armaments race appears as a realistic possibility and unless our defense strategy can be basically revised. This argument against early and substantial tax reduction is, of course, no argument against tax revision.

To promote economic expansion, I would recommend as a first step credit relaxation and would favor measures which would give increased financial support to residential construction and community development. Such a credit policy would have its greatest impact on those activities which have suffered most. Tax reduction would have a much more general effect and would have to be substantial before it could have an impact on such areas as residential construction. Relaxing credit first also has the advantage that it is more easily reversable than tax reduction and therefore more suitable in a still very cloudy international situation.

At the same time, I would urge that the problem of their price and cost push be studied for the purpose of developing an effective policy of price stabilization. Only when such stabilization policies have been developed will it be possible to make fuller use of fiscal and credit policies in support of economic growth. Until we have proper devices for dealing with the price and cost push, we should not throw away the fiscal brakes, crude as they are. We should use them, however, gently and should recognize that if used too hard, they may do more harm than good.

If the rise in national security expenditures could be held at the $45 billion level, or if these expenditures could be reduced, substantial tax reduction would not only be feasible but, in my opinion, become an economic necessity in future years. I believe it is premature to adopt such tax reduction now. Nevertheless, it is not too early to prepare for tax reduction now for adoption when the budgetary situation permits it and when the economic situation requires it. I am glad to know that this will be considered by subsequent panels.

STATEMENT ON REVISED BUDGET OUTLOOK, PREPARED BY GERHARD COLM AND MANUEL HELZNER, SUBMITTED IN CONNECTION WITH TESTIMONY OF GERHARD COLM BEFORE THE SUBCOMMITTEE ON FISCAL POLICY OF THE JOINT ECONOMIC COMMITTEE, JUNE 4, 1957.

This statement attempts to reevaluate the budget outlook in the light of more recent developments and in view of the experience of the past fiscal year. Of the two tables included in this statement, one presents revised estimates of budget expenditures and new obligational authority for fiscal year 1958. The other offers a budget outlook for the Federal Government covering the fiscal years 1956 to 1959. In the preparation of these revised budget estimates, we have had the fullest cooperation of the Budget Bureau. They have been helpful in making some of their information on expenditures and appropriations available to us. However, we assume full responsibility for deriving the estimates themselves.

The Congress has not yet completed consideration of the President's budget or of pending relevant legislation. Hence, we can only estimate what, at this time, the budget outlook for fiscal year 1958 might be. The revised budget estimates which have been prepared in Tables 1 and 2 below are based on the status of legislative action as of May 24th. Estimates have also been prepared regarding the expected budget impact of programs on which congressional committees have not yet acted.

TABLE 1.—*Revised estimates of the Federal budget—Fiscal year 1958*

[Billions of dollars]

	New obligational authority		Expenditures	
	In January budget	Revised estimates	In January budget	Revised estimates
Appropriation requests acted upon in some way by either House of Congress or Appropriations Committee: [1]				
Independent offices:	*Billions*	*of dollars*	*Billions*	*of dollars*
Veterans' Administration	4.9	4.7	4.9	4.7
Other	.6	.4	.5	.4
General Services Administration	.4	.3	.6	.6
Housing and Home Finance Agency	.1	.1	.1	.1
Department of Agriculture:				
Conservation and acreage reserve program (soil bank)	1.4	1.1	1.3	1.0
Commodity Credit Corporation (CCC)	1.2	1.4	1.4	1.6
Other Agriculture	1.1	1.1	1.2	1.0
Department of Commerce	.8	.6	.7	.6
Department of Defense—military	36.2	33.5	38.0	39.5
Department of Health, Education, and Welfare	2.6	2.5	2.6	2.5
Department of the Interior	.3	.3	.3	.3
Department of Justice	.2	.2	.2	.2
Department of Labor	.4	.3	.3	.3
Post Office	(3.3)	(3.1)	(2)	(2)
Department of State	.2	.2	.2	.2
Treasury Department	.7	.7	.7	.7
Subtotal	51.1	47.4	53.0	53.7
Other pending programs which affect the budget:				
Mutual security	4.4	3.8	4.4	3.8
Public works	2.3	2.3	2.0	2.0
Increase in veterans disability benefits		.2		.2
Increase in Federal outlays for housing programs		.2		.2
Interest on public debt	7.4	7.4	7.4	7.4
All other [3]	8.1	8.1	5.0	5.2
With possible allowance for supplemental appropriations		1.0		.3
Revised budget summary	73.3	70.4	71.8	72.8
With no increase in postal rates		.7		.7
Revised budget total	73.3	71.1	71.8	73.5

[1] Agency totals may not coincide with budget estimates since some budget items have not yet come up for consideration (for example, mutual security and public works). Also, some legislative items may have a budget impact but may not be considered by the Appropriations Committees.

[2] Less than 50 million. Assumes postal rate increase to be enacted. If rates not increased, net expenditures would rise by $0.7 billion.

[3] Includes Atomic Energy Commission and Defense Department—civilian.

Assuming that budget prospects as of May 24 would be sustained by later congressional action, table 1 suggests that new obligational authority for fiscal year 1958 would be reduced some $3 billion below January budget estimates. Estimated budget expenditures, however, would show approximately a $700 million increase. There are a number of reasons for this:

1. There appears to be an underestimation of expenditures in the President's 1958 budget in view of recent price and program developments. (E. g., increased costs of defense equipment and a possible increase in expenditures for agricultural price supports beyond what was anticipated explain some of this.)

2. Some of the reductions in new obligational authority apply to program expenditures beyond fiscal year 1958 and may not show up as expenditure reductions until later unless offset by additional appropriations in future years. (E. g., part of the reduction in defense authority affects long lead items and would not affect defense expenditures significantly until fiscal year 1959 or 1960 or beyond.)

3. Some of the congressional cuts simply involve bookkeeping transactions where the transfer of funds or the use of already approved obligational authority reduces total new authority but has little or no effect on expenditures. (E. g., roughly half of the reduction in Defense Department new obligational authority may be explained as bookkeeping changes.)

4. The introduction and consideration of new legislation may add to budget expenditures. (E. g., legislation to increase veterans' disability benefits and Federal outlays for housing programs.)

The revised budget total for fiscal 1958 takes into account the reduction in the President's revised estimate for the mutual security programs. Moreover, it also considers the possibility that the increase in postal rates might not be enacted and that requests for supplemental appropriations may be forthcoming at a later stage (particularly this might appear likely in the case of veterans' benefit payments which are fixed by law).

Table 2 below examines the budget outlook through fiscal year 1959. It does not consider the possibility or feasibility of a major change in our national defense program in Government nondefense activities or in our tax structure.

TABLE 2.—*Budget outlook for the Federal Government, fiscal years 1956, 1957, 1958, and 1959*

[Billions of dollars]

	Actual 1956	President's January budget estimate		Budget estimate		
				Revised		Projected
		1957	1958	1957	1958	1959
Administrative budget:						
Budget receipts	68.1	70.6	73.6	70.7	73.8	76.8
Budget expenditures	66.5	68.9	71.8	69.8	[1] 72.8	[1] 75.3
Major national security	40.6	41.0	43.3	43.2	45.2	46.7
Other nondefense programs	25.9	27.9	28.5	26.6	27.6	28.6
Administrative budget surplus	+1.6	+1.7	+1.8	+.9	[1] +1.0	[1] +1.5
Consolidated cash budget:						
Receipts from the public	77.1	81.7	85.9	82.0	87.0	90.8
Payments to the public	72.6	78.2	82.9	80.0	84.5	88.5
Consolidated cash budget surplus	+4.5	+3.5	+3.0	+2.0	+2.5	+2.3

[1] Assumes increase in postal rates. Without this assumed increase in revenue, net expenditures would probably rise by $.7 million in fiscal year 1958 and by $.8 million in fiscal year 1959.

Both revenues and expenditures for fiscal year 1957 continue to rise above 1956 levels. An economy still operating at relatively high levels of activity would account for most of the increase in revenues. The rise in national security outlays—primarily defense and atomic energy—would explain most of the increase in total expenditures. The increase in expenditures, however, will probably exceed the increase in revenues, thereby reducing the conventional administrative budget surplus below January expectations.

Assuming continued full employment levels and high performance in the economy, revenues in fiscal years 1958 and 1959 might be expected to rise by about $3 billion per year. The rise in expenditures for 1958, however, as we have already indicated, would offset most of this increase in revenues, thereby preventing any substantial increase in the administrative budget surplus. By fiscal year 1959, the rise in expenditures to meet national security programs may taper off somewhat so that we may experience a moderate increase in the budget surplus.

This budget outlook, however, should be qualified by an additional consideration. The 1958 and projected 1959 budgets presuppose that postal rates will be increased. If increased postal rates and higher postal revenues are not forthcoming, the surplus in both the administrative and consolidated cash budget would be reduced significantly and may even lead to a budget deficit.

The consolidated cash budget takes account of all receipts from and payments to the public and includes the transactions of Government trust funds. The outlook for a cash budget surplus or deficit over the next 2 fiscal years will, therefore, not only reflect activities such as the OASI program and the Federal National Mortgage Association, but will also be determined by the operating activities of the new highway trust fund. Hence, projections of cash budget receipts and payments must consider the speed with which the new highway program will be implemented. If there is no delay in the highway program, expenditures out of this fund should soon equal or exceed revenues. We have, therefore, assumed that the consolidated cash budget would continue to show a surplus but of a substantially smaller magnitude than in fiscal year 1956.

Representative MILLS. Our next panelist is Professor James Tobin, Department of Economics, Yale University.

Mr. Tobin, you are recognized.

STATEMENT OF JAMES TOBIN, DEPARTMENT OF ECONOMICS, YALE UNIVERSITY

Mr. TOBIN. Mr. Chairman, I took my part of the subject to be the implications for monetary and fiscal policy of a reduction in Federal Government expenditures below the budget. I am not an authority on the translation of appropriations into expenditures. Both Mr. Colm's statement and the statement of the Joint Committee Staff on Internal Revenue suggest that there is very unlikely to be any reduction in expenditure below the budget in 1958, even if there are reductions in appropriations. But in any case perhaps the issues I want to discuss will be applicable at a later date.

The other thing I do not want to talk about is the economic outlook itself, because that was also the subject yesterday, and I am not an expert or a close student of the short-term business outlook. It may be, of course, that regardless of changes in expenditures, some changes in fiscal and monetary policy would be necessary just because of changes in the economic outlook. I am not going to discuss changes in monetary and fiscal policy that would arise from that source, but rather the possible changes in monetary and fiscal policy that would arise if there were a reduction in expenditures; that is, if a reduction in appropriations brought about in some fiscal year a reduction in Federal expenditures below what is planned. So those changes, the changes I am going to be talking about, would be on top of or in addition to any changes that would be a result of the changing economic outlook itself.

I would like to endorse what Mr. Colm said about the importance of Federal expenditures both for national security and for certain nondefense social programs which have not had perhaps their fair share of resources during these years of cold war. So that although I am going to be discussing what changes in monetary and fiscal policy could be made if Federal expenditures could be reduced, it does not mean I am very happy about having a reduction in Federal expenditures. But I take it that is not an issue here today. That is a different question.

Well, if there were a reduction in Federal expenditures, then some resources would be released for the use of households, business firms, and State and local governments. The Federal Government would use less, and there would be more resources available for these other uses.

The first and most obvious task of fiscal and monetary policy is to make sure that the released resources are not wasted in unemployment. They must be absorbed in some combination of three basic uses: Private consumption; private investment in plant, equipment, durable goods, and inventories; capital projects and current services of State and local governments. Fortunately, there are a number of ways of insuring that resources released by the Federal Government will be absorbed in employment, and we have to make the choice among these ways on the basis of other criteria and not just the question of avoiding unemployment.

Two relevant additional criteria—I do not pretend to exhaust the list—are: First, the allocation of resources between current consumption and investment for the future, and also the allocation of resources between private uses and public uses; and second, the effects of current policies on the feasibility and flexibility of stabilization policy in the future.

And just to dramatize the issue by starting some extreme alternatives that would be available for monetary and fiscal policy if there were a reduction in Federal demands on resources, I have listed three polar types.

The first would be to reduce personal income taxes, especially low bracket personal income taxes, to the extent necessary to expand private consumption by the full amount of the reduction in Federal expenditures. Since some fraction of increases in after-tax incomes would be saved, the loss of tax revenue would have to exceed somewhat the reduction in expenditures. In this case, you would keep on tight money in order to restrict investment and rely on consumption to take up the resources released by the Federal Government.

The second is maintaining taxes, therefore increasing the surplus run by the Federal Government, and relaxing monetary and credit controls. The objective here would be to keep consumption down and permit the released resources to be absorbed in investment by private business and State and local governments.

The third method, or third policy suggested as an exereme type, has essentially the same objective as the second, except that investment is encouraged by tax concessions instead of by easy money: Tax concessions to encourage investment, maintenance of personal income taxes to restrict consumption, no change in budget surplus or in restrictiveness of monetary control.

The case for a large proportion of policies (2) and (3) in the final blend is essentially the case for investment against consumption. Present consumption levels for the bulk of our population must certainly be regarded as highly satisfactory in the perspective of our own past and the rest of the world's present and future. The speed of growth of the productive strength of our economy depends on the rate of private and public accumulation of productive capital.

The need to increase this rate is accentuated to the extent that economy in the Federal budget is achieved at the expense either of direct Federal capital accumulation or of Federal contributions to investment projects by other governments and private firms. For example, failure of the Federal Government to assist directly the school-construction programs of State and local governments argues for lowering the costs at which these governments can borrow.

So as far as the first criterion is concerned, the main thing is that investment—public or private investment—is the important thing for accelerating the growth of the economy; and the growth of the economy may be extremely crucial in the contest with Soviet Russia.

The second criterion I mentioned is the bearing of the current policies on future prospects for economic stabilization. Some current policies might conceivably maintain full employment and avoid inflation today only by making it more difficult to find policies that will achieve these objectives in the future. This consideration applies principally to the blend between policy (2) and policy (3), because policy (2)—budget surplus offset by easy money—is one that may reduce the policy alternatives available in the future. And the reasons for this, I will briefly try to indicate.

Budget surpluses have cumulative and enduring monetary effects of a restrictive kind; these effects are in addition to the more obvious and transient fiscal effects of a budget surplus in reducing disposable income at the time the surplus occurs. The lasting restrictive monetary effects arise from the fact that reduction in the national debt diminishes the liquidity of private wealth. It diminishes the liquid component of private wealth relative to the nonliquid private capital component of private wealth, and it does seem to me that the balance between these two components is a matter of great importance for the stability and growth of the economy. The inflation after the Second World War provides a case in point. At the end of the war private owners of wealth held much larger stocks of liquid claims relative to the existing stock of producers and consumers capital than they would normally wish. The subsequent inflation may be interpreted as the results of their efforts to correct this imbalance, lower their liquidity proportion, and increase the proportion of their wealth they held in stocks of producers and consumers capital. These efforts continued until the rise in prices and the growth of the capital stock had lowered the liquidity portion of the private wealth to a tolerable level.

The opposite kind of imbalance, too low liquidity in relation to private and public wealth, could result from a persistent policy of Federal budget surpluses. The capital stock would be growing; indeed, under policy (2) its growth would be stimulated by measures designed to restrain consumption and encourage investment. At the same time, retirement of Government debt would be diminishing the supply of net liquid claims. The community can be expected to accept this secular increase in the size of the capital component of wealth relative to the liquidity component only if it is accompanied by a corresponding increase in the relative attractiveness of capital as a vehicle for holding wealth. To find willing holders of the expanding capital stock, the Federal Reserve would have to keep reducing the yields on liquid assets and increasing the availability of credit to venturesome borrowers. This policy would be an especially difficult one to effect if the accumulation of capital itself tends to depress the prospective rate of profit on new investment.

There are, of course, circumstances where the deflationary effects of diminishing Federal debt would be a welcome antidote to strong inflationary forces. But within the international political environment and the national economic climate we now seem to have, the deflationary effects of debt retirement would have to be offset by a long-run trend toward easier and easier money and credit. While the total debt would be falling, Federal Reserve holdings of Government debt would probably have to rise in order to expand the volume of bank reserves. There are limits to the powers of the monetary authorities to make credit effectively easier. Some limits are legal and institutional; they concern such matters as the reserve requirements of Federal Reserve banks and member commercial banks, which could be reduced by congressional action. Other limits are economic; in the thirties the excess reserves of the commercial banks bore witness to the absence of willing borrowers who met banks' minimal standards of reliability. In the favorable economic weather today we seem very far from any limits on effective monetary expansion. But in a recession the limits would seem much nearer. Our current tight money policy must be counted a valuable asset in appraising the economy's defenses against recession. When brakes are on, they can be released. If they have already been fully released in the course of the normal growth of the economy at full employment, the Federal Reserve has no way to counter a recession.

The third policy is a method to insure that resources released from Government use are absorbed in investment rather than consumption, without entailing either additional debt retirement or relaxation of monetary restraints. I am not a close enough student of tax legislation to suggest the specific tax concessions that would do the job. Reduction in the tax rate on corporate income would no doubt improve the liquidity preconditions of corporate investment. I am not convinced that it would improve investment incentives; the Treasury would be reducing its share of the costs and possible losses of investment projects as well as its share of the returns. Instead, perfecting of loss-offset devices, accelerated amortization or depreciation, or even the direct method of allowing tax credits for investment outlays—these may be the promising areas for tax concessions designed to stimulate investment.

Policies (2) and (3) are both investment-encouraging policies, rather than consumption-encouraging policies, but (2) does it by keeping taxes up by relaxing monetary restraints, and (3) by reducing those taxes that bear upon investment. One difference in impact should be noted, that easy money policies encourage investment by State and local governments as well as by private businesses. The tax concession method of policy (3) favors only the corporations. So if policy (3) were followed, some special means of reducing the costs of public investment, those of State and local governments, might be desirable; for example, a Federal Government guaranty of local bond issues for specific purposes, such as school construction.

Representative MILLS. Does that conclude your statement, Professor Tobin?

Mr. TOBIN. Yes, sir.

(The complete statement is as follows:)

FISCAL POLICY IMPLICATIONS OF REDUCTIONS IN APPROPRIATIONS FOR FISCAL 1958

Statement of James Tobin, Yale University, before the Subcommittee on Fiscal Policy of the Joint Economic Committee, June 4, 1957

I shall examine the implications for monetary and fiscal policy of a reduction in Federal Government expenditures below the budget proposed by the President for fiscal 1958. I understand that the wisdom of such reduction is not the issue here, but I would like to make it clear that I do not regard the proposed budget as excessive. I do not sympathize with the assumption of budget reduction that I must take as the premise of our discussion here today. Since the President's budget proposal is taken as a point of comparison, the changes I shall discuss in monetary and fiscal policies are hypothetical. They are differences from the policies that would be appropriate if the President's budget were adopted, rather than differences from policies currently in force. Whether present monetary and fiscal policies could remain unchanged either under the President's budget or under a reduced budget is another question, which I shall not attempt to answer. The answer depends mainly on the short-term business outlook, on which the subcommittee has already received both material from the staff and the testimony of other experts.

A reduction in Federal expenditures for goods and services will release productive resources for the use of households, business firms, and State and local governments. The first and most obvious task of fiscal and monetary policy is to make sure that the released resources are not wasted in unemployment. They must be absorbed in some combination of three basic uses: Private consumption; private investment in plant, equipment, durable goods, and inventories; capital projects and current services of State and local governments. Fortunately there are a number of ways of insuring that resources released by the Federal Government will be absorbed in useful employment. Choices among them, therefore, can and must be made on the basis of additional criteria. Without attempting to exhaust possible relevant considerations, I shall discuss two additional criteria: (1) the allocation of resources between current consumption and investment for the future, and between private uses and public uses; (2) the effects of current policies on the feasibility and flexibility of future stabilization policies.

I shall discuss three alternative combinations of monetary and fiscal policies. These are pure types, and they can be blended in application to the extent it is desired to compromise among their objectives and consequences. The three pure policies are:

(1) *Reduction of personal income taxes, especially in the low-brackets, to the extent necessary to expand private consumption by the full amount of the reduction in Federal expenditures.*—Since some fraction of increases in after-tax incomes will be saved, the loss of tax revenue would have to exceed somewhat the reduction in expenditures. Tight money policy would continue to restrict investment.

(2) *Maintenance of taxes, increase in the Federal budget surplus, and relaxation of monetary and credit controls.*—The objective would be to keep consumption down and to permit the released resources to be absorbed in investment by private business and by State and local governments.

(3) *Tax concessions to encourage investment, maintenance of personal income taxes to restrict consumption, no change in budget surplus or in restrictiveness of monetary control.*

The case for a large proportion of policies (2) and (3) in the final blend is essentially the case for investment against consumption. Present consumption levels for the bulk of our population must certainly be regarded as highly satisfactory in the perspective of our own past and the rest of the world's present and future. The speed of growth of the productive strength of our economy depends on the rate of private and public accumulation of productive capital. The need to increase this rate is accentuated to the extent that economy in the Federal budget is achieved at the expense either of direct Federal capital accumulation or of Federal contributions to investment projects by other governments and private firms. For example, failure of the Federal Government to assist directly the school construction programs of State and local governments argues for lowering the costs at which these governments can borrow.

The second criterion is the bearing of current policies on future prospects for economic stabilization. Some current policies might conceivably maintain full employment and avoid inflation today only by making it more difficult to find policies that will achieve these objectives in the future. This consideration applies principally to the blend between policy (2) and policy (3), because policy (2)—budget surplus offset by easy money—is one that may reduce the policy alternatives available in the future.

Budget surpluses have cumulative and enduring monetary effects of a restrictive kind; these effects are in addition to the more obvious and transient fiscal effects of a budget surplus in reducing disposable income at the time the surplus occurs. The lasting restrictive monetary effects arise from the fact that reduction in the national debt diminishes the liquidity of private wealth. By private wealth I mean the aggregate net worth of private individuals and institutions. Many private assets are, directly or indirectly, also private debts; these assets and debts cancel each other in aggregating the net worth of the population. Aggregate private net worth is the sum of two components: (a) Net claims, both interest-bearing (the national debt proper) and non-interest-bearing (coins, silver certificates, and gold certificates) against the National Government, (b) the Nation's privately owned capital stock, i. e., the privately owned tangible productive resources of the society. The balance between these two components of private wealth—the liquidity component and the capital component—is, in my view, a matter of great importance for the stability and growth of the economy.

The inflation after World War II provides a case in point. At the end of the war private owners of wealth held much larger stocks of liquid claims, relative to the existing stocks of producers' and consumers' capital, than they would normally wish. The subsequent inflation may be interpreted as the results of their efforts to correct this imbalance. These efforts continued until rises in prices and the growth of the capital stock had lowered the liquidity proportion of private wealth to a tolerable level.

The opposite kind of imbalance could result from a persistent policy of Federal budget surpluses. The capital stock would be growing; indeed, under policy (2) its growth would be stimulated by measures designed to restrain consumption and encourage investment. At the same time, retirement of Government debt would be diminishing the supply of net liquid claims. The community can be expected to accept this secular increase in the size of the capital component of wealth relative to the liquidity component only if it is accompanied by a corresponding increase in the relative attractiveness of capital as a vehicle for holding wealth. To find willing holders of the expanding capital stock, the Federal Reserve would have to keep reducing the yields on liquid assets and increasing the availability of credit to venturesome borrowers. This policy would be an especially difficult one to effect if the accumulation of capital itself tends to depress the prospective rate of profit on new investment.

There are, of course, circumstances where the deflationary effects of diminishing Federal debt would be a welcome antidote to strong inflationary forces. But within the international political environment and the national economic climate we now seem to have, the deflationary effects of debt retirement would have to be offset by a long-run trend toward easier and easier money and credit. While the total debt would be falling, Federal Reserve holdings of Government debt would probably have to rise in order to expand the volume of bank reserves. There are limits to the powers of the monetary authorities to make credit effectively easier. Some limits are legal and institutional; they concern such matters as the reserve requirements of Federal Reserve banks and member commercial banks, which could be reduced by congressional action. Other limits are economic; in the thirties the excess reserves of the commercial banks bore witness to the absence of willing borrowers who met banks' minimal standards of reliability. In the favorable economic weather today we seem very far from any limits on effective monetary expansion. But in a recession the limits would seem much nearer. Our current tight money policy must be counted a valuable asset in appraising the economy's defenses against recession. When brakes are on, they can be released. If they have already been fully released in the course of the normal growth of the economy at full employment, the Federal Reserve has no way to counter a recession.

The third policy is a method to insure that resources released from Government use are absorbed in investment rather than consumption, without entailing either additional debt retirement or relaxation of monetary restraints. I am not a close enough student of tax legislation to suggest the specific tax concessions that would do the job. Reduction in the tax rate on corporate income would no doubt improve the liquidity preconditions of corporate investment. I am not convinced that it would improve investment incentives; the Treasury would be reducing its share of the costs and possible losses of investment projects as well as its share of the returns. Instead, perfecting of loss-offset devices, accelerated amortization or depreciation, or even the direct method of allowing tax credits for investment outlays—these may be the promising areas for tax concessions designed to stimulate investment.

Policy (3) does not allow for the monetary requirements of growth. Unless progressively greater tax concessions for investment are to be made, these monetary requirements would have to be met as soon as the initial impact of the concessions wears off. One method would be to carry the policy to the point of running a budget deficcit, so that the growth in the Federal debt over time would maintain the balance between the liquidity and capital components of private wealth. Another method would be progressive relaxation of monetary control; this has the same kind, but not the same degree, of disadvantages mentioned in the discussion of policy (2).

One important difference in impact between policies (2) and (3) should be noted. Easy money policies encourage investment by State and local governments as well as by private businesses. The tax concession method of policy (3) favors only the corporations. If policy (3) were followed, therefore, some special means of reducing the costs of public investment might be desirable. One method would be for the Federal Government to guarantee local bond issues for specified purposes such as school construction.

Representative MILLS. Our next panelist is Prof. Albert G. Hart, department of economics, Columbia University.

Professor Hart, you are recognized.

STATEMENT OF ALBERT GAILORD HART, DEPARTMENT OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. HART. Mr. Chairman, I hope you won't feel that your panelists are out of communication with each other, because I am about to produce a third type of statement. I hope I won't be considered to think that what has just been said is irrelevant. I think it is extremely relevant. I think we will be able to tie things up.

What I am offering is a rather broad swinging new look at fiscal policy from somebody who has been away from it for a couple of years.

In many of the utopian pictures of fiscal policy which have been drawn up in the past, you find Government spending set up as a policy variable which can be raised or lowered as may be needed to avert vast unemployment and inflation. We are not living in that kind of a world. The defense side of the budget dominates things so much that the whole swing in the expenditure side is pretty sure to be governed by how we feel at a given time about the national defense situation, and we are living in a world where there are going to be oscillations in this view. We tend to go into phases of complacency where we tend to push down Government spending, and then every now and then we get a jolt, and up it goes again.

The consequence is that if you think of fiscal policy for economic stabilization, it is on the tax side that the stabilizing influence must be exerted. On the whole, Government expenditure is something that will change a good deal. It may happen to turn out well from a stabilization standpoint, as in good part it has in the past, and it may happen not to.

When you start trying to gage the needs for taxes, coming back to budget figures I find myself very much handicapped, because I do not think that I know—and I do not think anybody can tell from the kind of figures we get—what the need for taxes is going to be. A good part of the meaning has gradually oozed out of our budget figures over the last few years, it seems to me.

This is primarily because there is so much on the defense side which represents items of long lead time. When you get a change in expenditure by Government on defense "hardware," this has very little relation really to current economic activity. The real impact of these expenditures was felt some time before the Government paid out the funds, when the suppliers incurred production expenses. And then eventually the Government comes around with a reimbursement. The consequence is that the timing of the effect of this major item, which is of the order of $25 billion in the budget, is very obscure, and it seems to me that until we get an accounting that gives us a picture of that, we do not have a clear image.

I suggest here that we have a good deal of what can be called privately financed deficit spending on Government account. During the defense buildup, this was an item of 6 or 8 billion dollars a year over years, and more than that in some quarters. Recently it seems to be running minus. That is, these reimbursements, including the rapid amortization of defense facilities, have outweighed the new things. besides defense facilities, one must also allow for the effect of inventory fluctuations in the defense sector, of which we do not have any good measures.

The difficulty is largely on the budgetary side, with the fact that we have a big carryover of unobligated authority to place orders. This is a curious phenomenon. The budget message has a description of the relation of appropriations, obligational authority, to expenditure. They say that rather than intending to cover expenditures of the current year, the appropriations are intended to cover obligations expected to be incurred within the fiscal year. (Obviously, if it was to cover only expenditures, the Government could never buy anything that took more than a few months to produce.) But the fact is, you see, that we have these large balances of unobligated authority carried forward. One would suppose from the description that the normal routine would be that the obligational authority granted would in fact be obligated and that unobligated balances would be canceled.

However, the current budget expects the Defense Department to enter the new fiscal year with $10.6 billion unobligated and to end it with $7.9 billion unobligated.

Just exactly what is meant by unobligational authority unobligated is something I am not able to find out from the documents. This is a matter, by the way, which has a lot of financial leverage in the economy, and the estimates on this are among our loosest. I just checked up with the recent budget messages. For July 1, 1955, the first estimate, which was made in January 1954, was that there would be $24 billion of unobligated authority. The estimate made in January 1955 was that it would be $34 billion. And it turned out to be $42 billion. Here is, if you like, the main index of the extent to which Government finance is out from under the congressional control and is really not represented by the budget figures from which we are asked to figure out the needs for taxes.

To forecast the effect of spending decisions of Government, in short, is as tricky as any problem of economic forecasting.

In this situation, it seems to me that we are entering a period when tax policy must be much more adaptable to the course of events than it has been since 1950. I have in mind in particular the problem of limiting the next recession, remembering that we have no way to predict accurately either its timing or its intensity.

On the record, in the last two recessions we had a fiscal policy which turned out rather well according to the economists' blueprint. If you look at these charts at the end of the paper, the first one, labeled chart A, shows the record according to the Department of Commerce national income accounts for the period from the beginning of 1947 until the middle of 1950. Following National Bureau practice, I have shaded diagonally in blue the downswing period, and the red shaded period in the left is the tag end of the World War I inflation. In this inflation period, we were running a surplus on national income product account, which tapered off as the inflation tapered off. We get a very rapid shift to deficit as the recession comes on, which goes to the strongest deficit—this is a quarterly series—in the first quarter of 1950, just at the time that the upswing definitely was established.

This would look fine, except that if you look at it you will observe that it was the red expenditure curve at the bottom which rose, rather than the blue tax curve at the top, which fell. The rise in expenditures was only rather incidentally related to economic stabilization considerations. It was not entirely unrelated; yet it was more good luck than good management that the surplus-deficit curve happens to turn out nicely in that period.

If you look at the second recession, which is pictured by chart B, here I start at the date where I broke the other off, the middle of 1950, and carry it through to the end of 1956, again quarterly. I have included in expenditures here the privately financed deficit; that is, I have allowed for the effect of the defense budget on defense plant installations, ex-amortization charged, and on the inventory in the industries most closely linked with defense-transportation equipment and machinery. On this basis, during the active inflation period we ran a rather nice surplus on national income account. That is largely due to the work of your committee in getting prompt tax increases, I would suspect.

During the inflationary period, the active inflationary period, we were on this basis. Then we went over to a deficit basis about the time of the check to inflation in March 1951, and remained on the deficit basis through the recession of 1954. However, you will observe that instead of increasing the scale of the deficit impact of Government during this period, we were reducing it. From the fiscal policy standpoint, what happened was that there was a fairly substantial sagging off of taxes, largely due to the termination of excess profits taxes, which was somewhat connected with stabilization policy. But this was overshadowed by the reduction in Government expenditure and the related effects on business inventory.

In short, we got through this recession largely on account of favorable developments outside the field of Government finance, I would be inclined to say. We certainly came through in good shape.

But it seems to me that on the record our relative success in meeting these two recessions has been more good luck than good management, and that we should be in a position where we could throw in more good management in case of a serious future recession.

Furthermore, if you combine this fact with the unreliability of forecasting, which I have indicated—the fact that we have trouble forecasting Government expenditures as well as the economic situation—it would seem to me that we need a more subtle tax adjustment mechanism than we have got. The main policy upshot, it would seem to me, can be summed up in two sentences.

In the first place, we need a system of economic accounting, for the past as well as currently, which will better register what Government is doing to the economy—taking in some sort of allowance for this privately financed deficit expenditure on Government account.

In the second place, we need some sort of mechanism to make temporary changes in the tax structure at intervals shorter than a year and reduce our dependence on unreliable forecasts—not taking a chance on having to ride for a year or a year and a half with the results of such an unsatisfactory forecast.

Representative MILLS. Does that conclude your statement, Professor Hart?

Mr. HART. Yes, sir.

(The complete statement is as follows:)

FISCAL POLICY IMPLICATIONS OF REDUCTIONS IN APPROPRIATIONS FOR FISCAL 1958

Opening Statement of Albert Gailord Hart (Columbia University) for Panel of Joint Economic Committee, June 4, 1957

In utopian pictures of fiscal policy aimed at economic stabilization, Government spending often figures as a "policy variable," to be raised or lowered as may be needed to avert mass unemployment and inflation. But in today's world of military insecurity, this sort of manipulation of expenditure is off the map. We are spending so much more than anybody would justify if we had peace that there is a natural tendency for any relaxation of world tensions to reduce Federal appropriations, and for the intermittent jolts which remind us of our danger to increase appropriations. The resulting changes may happen to conduce to economic stability or the opposite. If fiscal policy as a whole is to exert a stabilizing influence, it follows, taxation must take up the slack.

Needs for taxes cannot be gaged very closely for the oncoming year. Even if we adopt a specific assumption for the outcome of the appropriation process, we have to face the fact that much of the defense appropriations are to pay for equipment with a long lead time—to be ordered in 1957–58, and delivered 2 to 5 years later. The effect of a change in such appropriations on Government expenditure in the 1957–58 fiscal year, as everybody agrees, will be small. But the effect on Government expenditure itself is not all that we must consider. When orders are placed for such equipment, suppliers are led to put in new facilities and then to incur production costs—building up their inventory of materials and goods in process. Such business outlays based on military orders are in effect privately financed deficit spending on Government account. The economic effects of appropriations of this sort are felt before the equipment is delivered and Government funds paid out.

The problem is further complicated by the fact that there is a considerable carryover of unobligated authority to place orders from one fiscal year to the next. The current budget, for example, contemplates that the Defense Department will enter the 1957–58 fiscal year with $10.6 billion of unobligated authority and end the fiscal year with $7.9 billion. (This practice, by the way, conflicts with the dictum of the budget message that appropriations "are enacted to cover obligations expected to be incurred within the fiscal year," and is an index of the degree to which the appropriation process fails to control operations.) By using up some of the margin of discretion they had aimed to hoard up for later fiscal years, the Defense authorities might absorb a cut in appropriations and let almost no economic impact come through. On the other hand, they might slow down the rate at which they obligate funds through new contracts, so as to be able to get improved models of various weapons presently even though they have bad luck in getting new appropriations.

To forecast the effective spending decisions of government, in short, is as tricky as any problem of economic forecasting, even if we assume away the uncertainty about appropriations. For what it is worth, my forecast is that the combined effect of a cut in appropriations and the rapid advance of military technology will be to intensify the hoarding up of unobligated authority, and to shift orders to new models of unusually long lead time—stimulating business spending on defense production facilities, but holding back business spending on actual production costs.

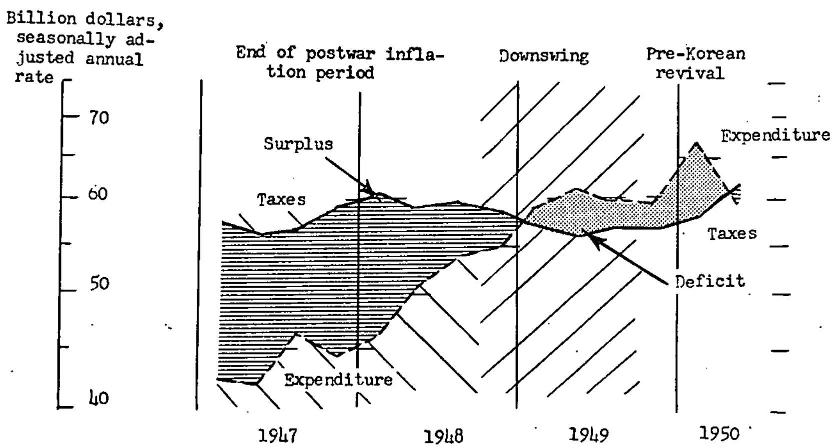
It seems to me that we are entering a period when tax policy must be much more adaptable to the course of events than it has been since 1950. I have in mind in particular the problem of limiting the next recession—remembering that we have no way to predict accurately either its time or its intensity. In both the last two recessions, as can be seen from the charts I attach, we got through so well largely by good luck. In the 1948–50 recession, the combined fiscal operations of Federal, State, and local governments shifted to a deficit basis just in time to cushion the downswing and help reverse it. But if you look closely at chart A, you will see that the deficit was opened out less by the drop in tax receipts than by a bulge in total government expenditures. The fact that this was the period of expanding Marshall plan outlays, of decompression of local public works after long delays, and of the dividend on government life insurance had some indirect relation to the easing of pressure on the economy; but the fortunate timing of the growth in expenditure (as well as of the personal-tax cut effective in January 1949) was more good luck than good management.

In the 1953–55 recession (chart B), we did have fiscal operations an a deficit basis. But if we allow for privately financed deficit spending on Government account, the effective deficit during the downswing was of about the same size as in the preceding boom; and the effective deficit tapered off during the downswing and turned into a surplus early in the upswing. Taxes on this occasion cushioned the recession by dropping sharply; and, of course, part of this drop reflected the end of the excess-profits tax, based on a correct expectation of reduced Government spending and reduced economic pressure. On the whole, though, we got our revival not out of fiscal policy but out of private spending on plant and equipment, the auto boom, and housing expansion (partly the fruit of easy money), and the reversal of the inventory swing.

In the next recession, we are likely to lack one factor which helped in 1953–55—the heavy backlog of defense orders. The amount of such orders outstanding has declined substantially relative to operations in industries that produce for defense, and a further fall seems probable. In consequence, business activity will probably be more sensitive to current fiscal policy (including new defense orders).

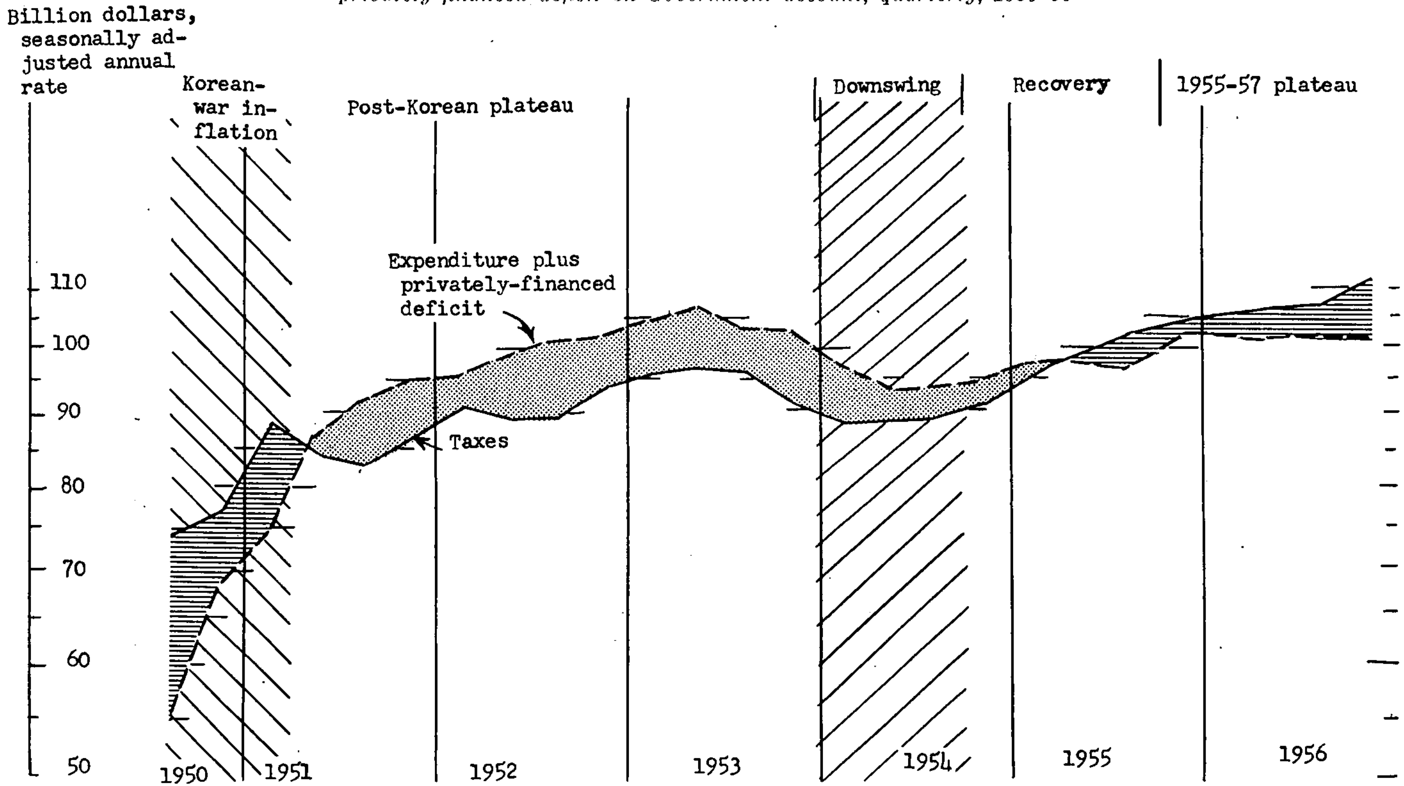
My conclusion is that it is urgent to lay plans for a tax cut that can be put in force on short notice if activity sags. In my judgement, any such cut should be in good part on a temporary basis—with reduced rates to revert to higher normal levels at a stated date unless Congress deliberately extends the reduction. Lacking this kind of advance planning, we are terribly dependent on unreliable forecasts. The ordinary pattern of enacting taxes in the spring of 1 year for application beginning in the ensuing January means that to have the right taxes involves accurate forecasting of tax needs more than a year ahead. Forecasting is not that accurate. But, as we saw in 1950, it is feasible to change income-tax withholding within the year (say on quarter dates), and to tune annual tax rates and declaration arrangements to the withholding. That is, we can put policy in line with business conditions by using much more reliable 3-month forecasts, if we can set up alternative withholding schedules, and focus the decision on whether to hold the present schedule or shift to another in the ensuing quarter.

CHART A.—*Fiscal operations of Federal, State, and local governments in relation to business activity, quarterly, 1947–50*



Source: Survey of Current Business. Surplus and deficit, "on national income and product account," are indicated.

CHART B.—*Fiscal operations of Federal, State, and local governments, including privately financed deficit on Government account, quarterly, 1950–56*



Source: See table C.

TABLE C.—*Fiscal operations of Federal, State, and local governments, including privately financed deficit on Government account, quarterly, 1950–56*

[Billion dollars: Seasonally adjusted annual rates]

Year and quarter	Government operations as shown in social accounts			Major items of privately-financed deficit on government account			Adjusted figures	
	Taxes	Expenditure	Surplus (+) or deficit(−)	Inventory growth	Defense facilities	Less amortization charged	Expenditure (B+D+E−F)	Surplus (C+G)
	A	B	C	D	E	F	G	H
Period 1, end of pos war inflation:								
1947:								
I	57	42	15	(*)	(*)	(*)	(*)	(*)
II	56	42	14					
III	56	46	10					
IV	59	45	14					
1948:								
I	60	46	14					
II	59	51	8					
III	59	54	5					
Period average	58	47	11	(*)	(*)	(*)	(*)	(*)
Period 2, 1948–49 downswing:								
1948: IV	59	55	4	(*)	(*)	(*)	(*)	(*)
1949:								
I	57	59	−2					
II	56	61	−5					
III	57	60	−3					
Period average	57	58	−1	(*)	(*)	(*)	(*)	(*)
Period 3, pre-Korean recovery:								
1949: IV	57	60	−3	(*)	(*)	(*)	(*)	(*)
1950:								
I	[a] 58	67	[a] −9					
II	[a] 62	60	[a] 2					
Period average	[a] 59	62	[a] −3	(*)	(*)	(*)	(*)	(*)
Period 4, Korean-war open inflation:								
1950:								
III	74	56	18	−1	0	0	56	16
IV	77	62	15	3	3	(#)	68	9
1951: I	89	69	20	3	3	(#)	75	14
Period average	80	63	17	2	2	(#)	67	13
Period 5, post-Korean plateau:								
1951:								
II	85	78	7	5	4	(#)	87	−2
III	83	83	−1	5	4	(#)	92	−9
IV	87	88	−1	3	4	(#)	85	−8
1952:								
I	91	80	2	2	5	−1	95	−5
II	89	94	−5	(#)	5	−1	98	−9
III	89	97	−7	1	4	−1	101	−11
IV	94	98	−4	1	4	−1	102	−8
1953:								
I	96	101	−5	1	4	−1	105	−9
II	97	103	−6	1	3	−1	106	−9
Period average	90	92	−2	2	4	−1	98	−8

93528—57——6

TABLE C.—*Fiscal operations of Federal, State, and local governments, including privately financed deficit on Government account, quarterly, 1950–56*—Con.

[Billion dollars: Seasonally adjusted annual rates]

Year and quarter	Government operations as shown in social accounts			Major items of privately-financed deficit on government account			Adjusted figures	
	Taxes	Expenditure	Surplus (+) or deficit(−)	Inventory growth	Defense facilities	Less amortization charged	Expenditure (B+D+E−F)	Surplus (C+G)
	A	B	C	D	E	F	G	H
Period 6, 1953–54 downswing:								
1953:								
III	96	101	−5	(#)	3	−2	103	−6
IV	91	102	−11	−1	2	−2	102	−11
1954:								
I	88	98	−11	−3	2	−2	97	−9
II	89	96	−7	−3	2	−2	93	−4
III	89	96	−6	−2	2	−2	93	—
Period average	91	99	−8	−1	2	−2	98	−7
Period 7, 1954–55 recovery:								
1954: IV	92	95	−3	(#)	2	−3	91	−3
1955:								
I	97	98	−1	(#)	2	−3	97	(#)
II	99	98	1	(#)	2	−3	98	1
III	102	98	4	(#)	2	−3	97	5
Period average	97	98	(#)	(#)	2	−3	96	1
Period 8, 1955–57 plateau:								
1955: IV	105	100	5	2	2	−3	101	3
1956:								
I	105	101	4	2	2	−3	102	3
II	106	102	4	1	1	−3	101	5
III	107	104	3	(#)	1	−3	101	6
IV	112	107	5	−2	(#)	−3	102	10
1957:								
I								
II								
III								
IV								

Sources: Cols. A–C: Survey of Current Business, with business taxes on an accrual basis. Cols. A–C: Survey of Current Business, national-income basis. Col. A shows corporate and indirect taxes on an accrual basis; see note (*a*) for adjustment in 1950. Col. B includes purchases of goods and services, transfers, and interest. Col. C is "surplus on income and product account" as included in "gross saving."

Col. D: Inventory changes in manufacturing of machinery and transportation equipment. Book values from Survey of Current Business are reduced to 1947–49 dollars by quarter-end values of the BLS whole values for Survey of Current Business are reduced to 1947–49 dollars by quarter-end values of the BLS wholesale index for machinery and motive products; changes are inflated back to current dollars by quarterly averages of the same price index.

Col. E: Rough estimate of plant and equipment put in place which is sufficiently defense connected to be covered by rapid amortization. Computed and seasonally adjusted by AGH for this memorandum from data of U. S. Treasury and Office of Defense Mobilization.

Col. F: Allocation of Treasury estimates of amortization deductions by years. This is subtracted as representing funds made available by reimbursement of contractors for earlier capital outlays.

Representative MILLS. Our next panelist is Mr. Edwin B. George, director of economics, Dun & Bradstreet.

Mr. George, you are recognized.

STATEMENT OF EDWIN B. GEORGE, DIRECTOR OF ECONOMICS, DUN & BRADSTREET, INC.

Mr. GEORGE. Mr. Chairman, my most recent business projection had already been shaded to allow for the budget cuts that I thought might be effective in fiscal 1958, and I trust it will serve as background for comment on policy matters.

I also trust that I may be permitted a few words on my expectations for the year, because their pattern rather than their absolute amount has some bearing on points of view that I would like later to develop.

As happened a year ago business has been good through a period of misgivings. With the help of a little inflation, it is true, first quarter GNP managed to climb above its fat predecessor in the closing quarter of last year. But we held our own in real terms. Moreover, the real volume of final purchases continued to increase, the failure of overall physical sales to rise being due to a shift from inventory accumulation to inventory decumulation. Unemployment, which is not subject to the statistical infirmities of GNP—although comparisons have been hampered by the recent change in base—is also reassuring. The April figure was down from the relatively low level of the same month a year ago despite secular rise in the civilian labor force. My own feeling from the beginning of the year and therefore prior to the budget commotion has been that business would go on to set another new record in fiscal 1958. This was to happen without benefit of tax cut and with nothing beyond marginal change in the attitude of monetary authorities.

This is not a forecasting session, and I will limit myself to the briefest references to the particulars supporting this expectation. Perhaps I can capsule them by saying that with a few exceptions—net foreign investment is the major one and for an obvious reason—I expect the strong elements to remain strong and the weak ones to strengthen. This prospect embraces: a modest gain in business fixed investment—extending into calendar 1958—a continued rise in overall Government spending; a moderate recovery in housing starts from April 1957 level, partly sparked by the Congress itself and reinforced by continued upward trend in unit values and further growth in outlays for additions and repairs to existing dwellings; later in the year a reversal of the current inventory trend. And, incidentally, may I observe there, as I did in the excerpted paragraph that was inserted at the wrong point, that one of the interesting features of the first quarter was the capacity for shock absorption that the system displayed, even though the test was a mild one, upon the reactivation of this traditional carrier of short-term cycles.

And a final satisfactory item was a persistent rise in consumer spending.

The accommodations made in this forecast for budget revision ran in the following sequence: (1) If not cut back, Federal GNP spending would run well above last January's expectations, owing in good part to greater-than-expected cost of defense weapons and to speedup in procurement procedures and progress payments on such items; (2) budegt cuts effective in fiscal 1958 would not dent such outlays by nearly enough to offset this initial underestimate; and (3) budget costs affecting such items as transfer payments, eventually reflected in other component of GNP rather than in Federal spending for goods and services, would be small. I also allowed for the probability that tax revenues will run somewhat above the President's estimate.

Mr. Chairman, like Dr. Colm, I did make an effort to measure the actual effects of the budget cuts on spending for the year and took them into account in the estimate of prospects that I have laid before you. My method of analysis was somewhat different from Dr. Colm's. I took the cuts of the Appropriations Committees as made by Congress to date, as given, and attempted to estimate their incidence for 1958 under three headings.

First, differences of opinion as to the workload of actual expenditures that would be required by existing law.

Second, the distinction that Professor Hart touched upon, between the expenditures that would be actually effected in 1958 and those that of necessity would carry forward into future years.

A third item fell under the heading of "Bookkeeping," which merely resulted in a transfer from one appropriation heading to another.

There is really a fourth that does not bear particularly on our present discussion, and that is the difficulties created for public service by cuts in some of the small administrative services, that are not widely publicized.

The upshot of it was that I arrived at an effective net impact for 1958, taking into account some unrequested increases, which was so small that it lay well within the margin of error, I think, of any of us, in computing what is going to happen in the future.

Thereupon, I had to allow only for changes in prices, to which we have to be resigned, from now through fiscal 1958; which has brought me to the conclusion that, despite the difference in method, closely resembles that reached by Dr. Colm.

In developing my projection, I assumed that the Federal would hold growth in the privately held money supply, including time deposits, to the rate prevailing in calendar 1956 (around 2 percent). On our projection this involves a further assumption that room exists for still another step-up in velocity. There is a change that the exigencies of Treasury financing may force the Federal to be a bit more lenient on the supply side. If so, GNP would exceed my expectations—although I do not want to lay too much stress on a forecast of that kind, because it implies a degree of precision that is hardly obtainable.

The committee requested views on a few aspects of fiscal management.

First, the concept of debt management: I think that this should be responsive to both the needs of sound money policy and the needs of individuals and institutions for different kinds of paper. Sometimes they will be contradictory, and compromises will be necessary.

The Treasury's own problem is to maintain a good distribution of the public debt among maturities. Each age-group has its own cyclical as well as fiscal function. But under present circumstances it is difficult to lengthen maturities so that imbalance is likely to persist.

Cash balances: The Treasury's freedom of action is hampered at the moment by the urgency of its cash needs but there is no easy remedy. Tax increases now would be tactically absurd, and, I might add, economically unwise. Federal expenditures cannot be reduced soundly in a hurry, as we are now witnessing.

Debt reduction: To the extent that surpluses are generated partly by inflation, they should be applied to noninflationary forms of debt reduction rather than tax reduction.

As to monetary policy, near-term problems were touched upon earlier in the course of testing the feasibility of implementing expected demand.

Conclusions and recommendations: I doubt if we will be facing any problem of compensatory action to avert recession in fiscal 1958—or even in fiscal 1959. At least, as concerns 1959, anything we would want to do would lie within the limits of what Congress would like to do on taxation. With respect to longer term matters, I should like simply to refer to my earlier paper for this committee on economic growth and stability.

In closing, may I merely mention some problems in budget management that underlie technical questions of the kind posed to us. I beg your indulgence in allowing me to make these points that are just slightly off the target.

First, as citizens we are not really prepared to take over problems of budget direction, which is the role in which many of us have in effect been casting ourselves. Perhaps public consciousness of the budget may have spread widely enough at the moment to support the creation of a permanent and broadly based citizens' budget committee with its own technical staff.

Secondly, it is difficult for the most sophisticated groups to criticize much of the budget realistically. Hundreds of items are scattered throughout the budget without visible attachment to the programs actually responsible for them. Over time, in line with a start already made by the Budget Bureau, and for which I think it deserves compliments, it should be recast in terms of objectives, programs, or missions, with the costs of each, wherever occurring, correctly identified and charged. With the present format, when a major program is launched, enlarged, or reduced, there is often no way of knowing the true cost effects.

And third, the ultimate costs of programs as well as benefits should be advertised. The biggest programs often start modestly. This reticence is particularly damaging in the case of some defense and welfare programs.

I apologize for the diversion, but I do think the lack of some of these measures very seriously underlies some of the problems that we face in the forms in which they are first identifiable.

(Mr. George's prepared statement and supplemental materials follow:)

Fiscal Policy Implications of Reductions in Appropriations for Fiscal 1958

By Edwin B. George, director of economics, Dun & Bradstreet, Inc.

All of the committee's quesions about the effect of appropriation cuts on future Federal surpluses and about the sundry fiscal and monetary actions that may thereupon be called for, require an initial deposition by the witness on the business climate he was otherwise expecting. My own most recent projection does not precisely meet this test because it was made during the debates on the budget and included some early assumptions about their outcome. Prior to a sharpening of the distinction, I will give you the gist.

As happened a year ago, in the winter and spring of 1956, we have been doing very well during a period of misgiving over current and near-term developments. With the help of a little inflation, it is true, first quarter GNP managed to climb above its fat predecessor in the closing quarter of last year. But even in real terms we did a little better than break even. Unemployment, which is not subject to the statistical infirmities of GNP—although comparisons are hampered by the recent change in base—is also reassuring. The April figure was down from both the preceding month (seasonally adjusted) and from the same month a year ago despite secular rise in the civilian labor force. My own feeling, from the beginning of the year and therefore prior to the budget commotion, has been that business would go on to set another new record in fiscal 1958. This was to happen without benefit of tax cut and with nothing beyond marginal change in the attitude of monetary authorities.

This is not a forecasting session, and I will limit myself to the briefest references to the particulars supporting this expectation. Perhaps I can capsule them by saying in the main, I expect the strong elements to remain strong and the weak ones to strengthen. Practically all surveys of business investment plans justify an interpretation that outlays will continue to rise during the year. It is a safe inference also that they will rise through most of 1958, because plans already in place are so close to present levels of commitment that the historical hardening process that takes place as the time for decision draws near will more than bridge the gap. The fortunate loss of Suez relief business will not go so far as to turn our export surplus into a deficit. Barring failures elsewhere in the system, which I am in the process of excluding, there is nothing to throw personal incomes off their secularly rising trend, or to induce consumers themselves to save at even as high a rate as they did on the average last year. Logically, as I am still dealing with previously strong elements, I must say here that I expect overall Government spending also to continue in its upward course. The question actually before us is begged by such a contention at this point, but I will meet it more squarely later.

Two of the laggards in the system have been nonfarm residential construction and inventories—the latter qualifying but recently. It looks as though money stringency would continue to afflict housing, it being low man on the totem pole partly because of Government policies. There is not a hope of starts topping a million this year, but the upward trend in average values per unit and outlays for additions and repairs persists. The vacancy ratio is close to vanishing point, families are larger than they used to be, and I would not be surprised if the recipe developed in conference by the House and Senate after the latter passes a bill will give some stimulus to starts by fall or early winter at the latest. More probably than not, next spring the seasonally adjusted annual rate of starts will be running over a million.

The stock sales ratio is now receding from a level that few regarded as very dangerous. There have been bulges, of course, that required some deflation, but not a great deal of room in which the process could spread. Some inventories seem currently to be on the low side. One of the interesting features of the first quarter was the capacity for shock absorption that the system displayed, even though the test was a mild one, upon the reactivation of this traditional carrier of short-term cycle. My guess is that reduction in stocks will cease sometime in the fall at the latest.

I must say here that this estimate of prospects took the budget revolt into account—not in exact dollar terms, which is still impossible, but at least roughly. The kinds of allowance made were (1) that in the absence of budget cuts Federal GNP spending would run well above last January's expectations, owing in good part to greater-than-expected cost of defense weapons and speedup in procurement procedures and progress payments on such items; (2) that budget cuts effective in fiscal 1958 would make only a modest dent in Federal outlays on GNP account—considerably less than enough to offset the initial underestimate of expenditures; and (3) that at most only a moderate net reduction from the rate forecast in the budget message would be made in budget outlays (e. g., transfer payments) which are reflected in other components of GNP. In my opinion, my overall GNP projection makes adequate allowance for such effects as well as for the probability that tax revenues will run somewhat above the President's estimate.

Some general support for the three points—though not necessarily for the judgment in the immediately preceding sentence—has recently come forth from the staffs of both the Internal Revenue Taxation Committee and the Joint Economic Committee. A couple of weeks ago fiscal 1958 outlays were estimated by the former as likely to run close to a billion dollars above the administration's January forecast. Overall, the staff of the Internal Revenue Taxation Committee now expects the administrative surplus to be about a half-billion less than the $1.8 billion predicted by the President despite moderately greater tax revenue than he foresaw. The Joint Committee staff likewise appears to expect heavier spending, for although their estimates of calendar 1957 corporate profits and general activity imply that tax yields will be significantly larger than expected by the Taxation Committee in fiscal 1958, they still place the administrative surplus for that fiscal year in the range of only $1 to $2 billions.

Beyond fiscal 1958 the Committee included in its questions a brief reference to spending prospects for subsequent years. It is well understood that a substantial proportion of the current budget cuts cannot be immediately effective and that some of them have to ride out existing authorizations for several years. Forecasting for the longer pull, therefore, involves double jeopardy. Circumstances will change, and both executive and legislative scales of value may change with them.

It should be recognized parenthetically that a few of the jumps in cash budget outlays recorded over the past year or two are of the nonrecurrent type. Almost half of the increase in foreign aid during that period does not reflect a permanent enlargement. Cash for foreign loans by the IMF was obtained from the United States Treasury in redemption of notes issued to the fund by the United States in fiscal 1947; repayment will eventually show up as cash receipts. About $0.7 billion out of $1.5 billion projected increase in foreign aid was thus accounted for. Similarly, social insurance and retirement funds has to be debited by the evtraordinary amount of $2.5 billion between fiscal 1956 and 1958, in part because of the lowering of retirement age for women and the new disability provisions. Here again, however, only the cash budget is affected—though of course the outlays affect consumer spending.

In the regular budget, however, spending pressures are rising even apart from those already latent in unspent authorizations (including both unobligated and obligated funds) and in new programs, the ultimate costs of which have not yet been announced or perhaps even appraised. Comment on these potentials divides simply enough into the categories "defense" and "other."

Defense.—No one will charge the Congress with callousness toward real defense needs. There have been times when security was pinched by both executive and legislative branches, but these have usually been times of approximate peace and not those fraught with definite peril, as at present.

Last year the Congress was criticizing the Defense Department for excessive economy and actually pressed additional funds upon it. This year, with no great changes in program other than those imparted by the continuing shift from conventional to modern weapons and particularly sharp price increase in components, parts, and subassemblines entering into military hard goods, the stress is on economy. The citizen has to decide which of these Congresses is more nearly in character, or whether each merely reflect a logical response to changing circumstances and is therefore not predictive at all. For its part, the Kremlin will hardly be in character if it abstains for 2 years from creating new disturbances that will give the Congress new concern. And even without new disturbances, new needs are brewing. Operating and support requirements for continental defense will soon require people and funding. If some of the more nervous ideas were to prevail, purchases of land to prevent encroachment on air facilities could run into very high figures. Although the original intention, I believe, was to attract private money through loan guaranties, FNMA's purchases of mortgages on military housing are increasing. I cannot foresee the ultimate disposal of the Cordiner Committee proposal to increase pay scales in order to attract and hold servicemen. Some strategists feel that a breakthrough is overdue on even the type of weapons needed to deal with modern brushfires and peripheral wars and that their cost could be substantial.

Other.—To begin with, only a bold man would adjudge that the long cycle of rising welfare benefits has run its course—or even tha it is a cycle. Within immediate visibility, outlays for highways (affecting the cast budget), veterans' benefits, welfare, and housing (including community development, education, and public health) are on the rise. Through prolonged prosperity, outlays for public assistance, housing, and agriculture might have been expected by an astral auditor to decline, and their failure to do so casts doubt on any presumption that the peak has been reached.

Finally, under this heading, it is not impossible for the Congress to have second thoughts about some of the useful little services that have suffered acutely in the present economy drive. Little that Congress does works more pervasively through business efforts to cut costs and prices than does the support of statistics. This is a lowly political item and parades on its behalf are infrequent, but the yield of the country from small investments in them can be very high. Congressmen close to the subject may be numerous enough to influence others whose interest and abilities center in other fields. Capital equipment for accounting and records management means economy for the

Government. With the jet-turbo-prop age of commercial airlines upon us, there will be no letup in the need for more and better equipment for the airways, including radar and weather service (which by the way is far from being a "little" service). Eventually, I think there will be a new appreciation of the importance to this country of nonmilitary defense—a much broader concept than that of controversial "civil defense." Of small cost, it is a large undertaking involving plans for the swift reorganization of all the surviving resources of a shattered and stricken nation after such an attack, in a hundred major ways—emergency reconstruction of broken chains of production from raw material to vital finished products, the simple essential of national and community financial solvency, continuity of government and business managements, adaptation of legislative and judicial processes, etc.—all these in the race to pick ourselves up off the floor faster than the enemy, which is the proper description of another war. In concept it is the exact complement of military preparedness as a deterrent to war; but to the one we give $43 billion, to the other a few million about to be cut, and at the moment badly in need of 4 or 5 specialists from certain industries and professions. And I think that several other small programs could meet three tests in a pattern that on "the morning after" will bother many Congressmen: (*a*) of giving the public a good return for its money, (*b*) of lacking politically organized support, and (*c*) of having been cut with disproportionate severity.

The committee requested views on a few aspects of fiscal management.

Concept of debt management.—Debt management should be responsive to both the needs of sound-money policy and the needs of individuals and institutions for different kinds of paper. Sometimes they will be contradictory but equity is involved in the compromises.

From the Treasury standpoint alone, a major problem is to maintain a distribution of the public debt among maturities which takes cognizance of numerous objectives. There should be an appropriate volume of near-dated debt to meet the requirements of financial institutions and other holders for secondary reserves, but which is also subject to retirement out of surpluses when it is important to release money for long-term needs. On the other hand, this volume of near-dated debt should not be so large as to immobilize Federal Reserve policy during a period when momentary restraint is in order. The latter can readily occur, if the volume of near-dated debt is too large, for two reasons: (1) The Federal cannot be wholly indifferent to the success of Treasury refunding operations, and if the latter has to make frequent trips to the market, the periods during which the Federal Reserve is free to pursue policies of restraint might be unduly limited; (2) a volume of holdings of short-term securities which is generally "too large" means that financial institutions can always circumvent monetary restraints by permitting their holdings of short-term securities to run off. This was a clear lesson in the postwar period, the most recent manifestation being in 1954–56.

As to the latter suggestion, the obvious question at the moment is: Why does the Treasury not lengthen maturities in a period of prolonged prosperity? All that I can say is that I am impressed by the considerations that the Treasury (*a*) does not wish to exacerbate already tight markets at the expense of business requirements within the system's productive capacity, (*b*) cannot afford to allow its new issues to fail, and (*c*) is reluctant to pay extremely high rates whatever the monetary logic or the long-term trend.

Then is there ever a good time for lengthening? Apparently between confirmation of recovery and the upper range of resource use. There is always the possibility of neutralizing the transitional effects of lengthening through monetary measures, although the effort would probably evoke outcries over "contradictory policies."

Cash balances.—The foregoing questions interlock with that relating to the desirable level of Treasury cash balance. At the present moment the Treasury's freedom of activity is hampered by the urgency of its cash needs. It cannot choose its own time for new offerings, it must make them in a pattern that worsens the existing imbalance in the public debt, and it must inject itself into tight markets in ways that aggravate existing strains. This dilemma could be resolved by raising taxes or reducing expenditures. The first is tactically absurd at the moment—and economically unwise as well—and the second is the common denominator of all the topics on which you are inviting comment.

Debt reduction.—It would seem to inhere in the terms of the problem that to the extent that surpluses are fed by inflation they should be applied to noninflationary forms of debt reduction rather than tax reduction. Such a presumption would have to be overcome by a finding that the inflation was over and that so strong a deflationary reaction was about to set in that it could not be held within tolerable limits by built-in stabilizers plus monetary stimulation. I can see no support for such a finding at the moment.

Monetary policy.—At the moment, I don't see need for much change. As stated, my GNP projection, which envisages slightly higher prices (i. e., a rise in the composite index of GNP deflators) and implies a seasonally adjusted rate of unemployment averaging between 4 percent and 4.5 percent, assumes only marginal relaxation in the existing degree of restraint. My guess would be that the Federal may be formed to "ease off" to this extent to avoid extreme embarrassment to the Treasury in its refinancing operations. As to longer term policy, my text is already of such length that I would prefer to bypass the question—especially since some of the other panelists are certain to have a good deal to say about it.

CONCLUSIONS AND RECOMMENDATIONS

With respect to the short term, I don't see where there is much to be said. My analysis requires me to hold that we shall not face any problem of compensatory action to avert recession in fiscal 1958. For fiscal 1959, I suspect this will be true, too. More important, however, it strikes me that anything we might need to do in the latter year will lie within the limits of what Congress would like to do on taxation, anyway, and would probably do with about as good timing as the Government would in fact do anything else we could recommend now.

The longer term is another matter. With respect thereto, I should like simply to refer to my paper on Economic Growth and Stability, and then to comment on one aspect of the fiscal problem that is not strictly speaking on our subject, but nonetheless has considerable general importance; namely, how to manage the budget itself.

Here I have several observations to make:

1. Perhaps public consciousness of the budget has spread widely enough to support the creation of a Citizens' Budget Committee with full-time staff, whose members can soak themselves in budget techniques and values. There are such citizens' advisory committees in many large cities whose views make headlines and exert influence at least at the edges of their own big budgets. Such a national committee could (*a*) hold a light on big and small matters raising important issues of principle, and prepare objective analyses of the considerations involved; and (*b*) help individual Congressmen (1) by providing counterweights to organized pressures that even if small would at least be in the public eye and therefore always have a chance of making themselves felt; and (2) by providing symbolic support for the valuable small services that in his own heart the Congressman would not like to injure; (*c*) insure that after provisional judgment as to desirability of various outlays have been made, their total is appraised in light of the overall burden on the economy which it implies. Here, of course, stress has to be placed on relative burden. What is tolerable in relation to what is worthwhile is a never-ending dilemma.

2. Over time, I would like to see the budget recast in terms of objectives, missions, and programs, with the costs of each, wherever occurring, correctly identified and charged. I feel that we still have a long way to go to get the budget into the structural form that will permit intelligent control and revision. We still lack a good basis of cost allocation by comprehensible aims. Hundreds of line items are scattered throughout the budget without visible attachment to the programs actually responsible for them. An air wing, naval squadron, or artillery battalion must obviously be backed up by initial investments, maintenance allowances, personnel and personnel training, real estate, standard parts and supplies, fuel, etc. Such costs will appear in dozens of places but never be identified by missions. When a major program is launched, enlarged, or reduced, there is no way of knowing the true cost effects. Budget Bureau personnel can often make shrewd conjectures and the Bureau recently indeed has been moving definitely toward cost allocation, but there is still a long way to go and a considerable investment would probably be required for a thoroughgoing job. Government has no monopoly on this problem. Over recent decades business has made great progress in allocating factory overhead by end products or product categories, but is still struggling with distribution. But nobody is as big or complex as Government, or needs the remedy as keenly.

3. We should overcome our reluctance to advertise ultimate costs as well as benefits. The biggest programs often start modestly and we had better regard the price tags rather than the downpayment as the more important if we do

not want to be storming futilely about economy another few years hence. This reticence is particularly damaging in the case of defense and welfare programs.

Estimated effects of House-approved budget reductions on Federal spending in fiscal 1958 (as of May 28, 1957)

[In millions of dollars]

Agency	Reduction (1)	House workload estimates [1] (2)	Discretionary reductions not effective in fiscal 1958 [2] (3)	Bookkeeping items (4)
HEW	95	79		
Treasury, Post Office	80			
Commerce	218	8	150	
Labor	28	[3] 32		
Interior	61			
General Government	5			
Independent Offices	538			
Veterans' Administration		193		
FCDA			72	
General Services Administration			130	
State	48			
Justice	7		[4] 6	
Agriculture	299			
USIA	38			
Defense	2,587		[5] 1,354	[6] 590
Total	4,004	312	1,712	590
Less cols. 2, 3, and 4	2,614			
Total	1,390			
If postal rates are not increased	600			
Total	790			

[1] Examples of reductions made because House differs with executive branch on estimates of workload for required programs.
[2] Examples of reductions which chiefly affect authority to incur obligations and will not have much effect on expenditures until after fiscal 1958 (and which may subsequently be modified).
[3] Includes cut of 20 in grants to States for administration of employment security.
[4] Prisons.
[5] Army, 516; Navy, 400; Air Force, 438.
[6] Bookkeeping transfers from stock and industrial funds: Army, 400; Navy, 190.

The precision suggested by some of the more exact figures above is of course impossible at this stage. The assignment and purpose was merely to convey a general idea of the spread of the recent budget cuts over categories diversely related to effectiveness.

Thus, as of present writing, the budget reduction is hauled down to quite modest proportions. I could have gone further and tried to quantify some additional very likely causes of spending during the year, but such an effort would be even more speculative than that risked in the table. Citations, however, may be useful. For example, legislation is already well advanced to increase both veterans' disability benefits and Federal outlays for housing. Some put the likely cost at around $200 million each, some higher. In addition, CCC estimates may be low, Southwest disaster loans may be higher than expected, and apart from the obligation to make good on payments required by law (second column), other supplemental and deficiency appropriations are to be expected. Provision for even such minor supplements could carry spending above the level projected by the administration last January at constant prices. Perhaps most important, the President's budget appears to have underestimated significantly probable outlays for national security—due primarily to underallowance for prices of defense hard goods.

Representative MILLS. Our next panelist is Mr. William Butler, vice president of the Chase Manhattan Bank.

Mr. Butler, you are recognized.

STATEMENT OF WILLIAM F. BUTLER, VICE PRESIDENT, THE CHASE MANHATTAN BANK

Mr. BUTLER. Mr. Chairman, in this brief opening statement I propose to set forth a few personal conclusions I have reached on the role of fiscal policy in contributing to high employment, economic growth, and price stability. In the process I'll also try to comment on the current situation.

First, it seems to me that appropriate fiscal policies can make an important contribution to the maintenance of sound prosperity. By the same token, unwise policies can complicate the problem of avoiding both inflation and deflation.

Secondly, I believe fiscal and monetary policies should work in a mutually reinforcing fashion. When the problem is one of containing inflation, we need a tight money policy and a Government surplus. If business activity shows signs of sagging, credit should be eased. The Government surplus will shrink automatically as the "built-in stabilizers" operate in a period of declining activity.

I think most competent economists would agree with these general propositions. The difficulty arises when you start prescribing specific doses of monetary and fiscal policies to be applied in particular situations.

In this connection, experience during the past year is instructive. In this period we had a tight money policy and a surplus of about $3.5 billion in the Federal cash budget. We also had an increase of 4 percent in the consumer price index.

This strikes me as a most serious situation. Most of our inflation in the 1945–55 decade could be attributed to wars, or to the failure to have appropriate monetary and fiscal policies. In the past year we have had policies working in the right direction in both fields, and inflation as well.

What does this mean for fiscal policy? In my judgment, it means that we need a larger Government surplus in periods of high activity than we have had in the past year. After all, the Federal cash surplus ran to less than 1 percent of gross national product during the past year. That's a pretty small anti-inflationary dose.

How big should the surplus be? It seems to me that the only way to answer that question is through a trial and error process. As a rough guess, I'd suggest that the cash surplus should have been twice as large in the last year.

If this judgment is correct, it poses the hard question of how to achieve a larger surplus in periods of high level activity. So far as I am aware, no one has advocated raising tax rates to cope with the current inflation. Nor would I, for I think tax reduction and tax reform are particularly important in insuring that we maintain what the London Economist termed "a developing economy."

The alternative would be to cut Government spending enough to—

(1) achieve a cash surplus of around 2 percent of gross national product in years of high-level economic activity; and

(2) make it possible to reduce and rearrange our tax burden.

Given the need for a continued high level of national security expenditures, I see little prospect for any large-scale reduction in Government spending. I would certainly urge that every effort be made to achieve greater effectiveness in the expenditure of defense dollars—I'm appalled by estimates that the Russians seem to get about as much military strength as we do by devoting about half the resources (in terms of manpower and material) that we use. However, I do not believe it is realistic to assume that Government spending will be cut very much unless the Russians should become persuasively peaceful.

In the short run, therefore, it seems that we must try to muddle through with too small a surplus and with a tax system that is badly engineered to the specifications of a growth economy. This places a greater burden of responsibilitty on monetary policies than I believe to be desirable in the long run. However, we may be able to get by—the recent behavior of commodity and wholesale prices may well indicate that monetary policies have been successful in checking inflation.

In the long run, the growth of tax revenues from an expanding economy gives us more leeway. If we can hold down Federal expenditures for a few years, and keep the economy moving ahead, we should be able to have a larger cash surplus and cut tax rates, too. In the past decade our economy has achieved a real growth of about 4 percent per year. If we can maintain that pace, Federal receipts under the present tax structure should rise $3 billion to $4 billion annually in the next few years. It is my view that part of this growth bonus should be used to increase the Government surplus, and part should go to overhaul our tax system.

In an economist's traditional roundabout fashion, it seems to me that I have given my answers to a number of the perplexing problems posed to this panel. By way of winding up, I'll offer some quick answers to some of the other questions.

First, I think the business outlook for the next year adds up this way: Overall activity promises to stay virtually level until fall. But it should pick up thereafter, and the improvement should carry over into 1958. Thus, any increase in the budget surplus for fiscal 1958 should be used to help promote price stability.

Second, I do not believe we shall have a large enough cash surplus to justify tax reducion in fiscal 1958, though I would hope we would be able to cut taxes in subsequent periods.

Third, I think we have a great deal to learn about the use of debt management as a stabilizing tool. After all, we have had only a few years' experience in managing a large debt without Federal Reserve pegs. However, it seems to me that we could do more to restrain inflation through debt management than we have done recently. And it seems clear that we could do more if, as I have suggested, we had a larger surplus. Debt management is a complex and technical subject, and one in which other members of this panel are more expert than I. In general, I would favor policies to lengthen the debt in periods of high economic activity. It would seem that this can best be done by increasing the proportion of intermediate term issues. In addition, interest rates should be flexible enough to increase the proportion of the debt held in the form of savings bonds.

I've dealt very lightly with a series of weighty subjects in this brief statement. In the process, I'm sure I have raised more questions than I have answered—and that's not hard to do in a discussion of fiscal policy. However, I should be glad to try to answer any questions posed by the subcommittee.

Representative MILLS. Our next and last panelist is Dr. John D. Clark.

Dr. Clark, we are pleased to recognize you.

STATEMENT OF JOHN D. CLARK, FORMER MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. CLARK. Mr. Chairman, if I were a spokesman for the Council of Economic Advisers I would be saying: "This is where we came in."

The Council, organized to devise national economic policies to soften the supposedly inevitable postwar depression, had hardly found office space when it was facing a rapid inflation and a great business boom. It was caught up in a fiery contest between a President who stoutly opposed tax cuts and was willing to use his veto to stop them, and a politically hostile Congress determined to reduce wartime tax rates. Today the parties are more polite, and the congressional leaders are less determined, but the President is equally insistent upon a position which is exactly the same as that taken by Mr. Truman 10 years ago.

The Council of Economic Advisers, upon both occasions, has backed up the President with unqualified opinions that the current inflationary movement was threatening enough to require anti-inflationary policies, the most important of which is supposed to be the maintenance of high levels of taxation. The Council has had complete confidence in the theory that high taxes have a depressing effect upon business investment and consumer buying, and that the lowering of taxes is inflationary.

My own thinking upon this subject received a severe jolt at an early hearing by the Joint Committee on the Economic Report, when Senator Taft was chairman. He was a serious student of these matters, and I was given pause when I heard him say that in his opinion high taxes were inflationary.

If this is true, the economist loses the starting point for nearly all of his theories about fiscal policy in relation to economic stability. To judge from current economic discussions in and out of Government circles, the economists harbor no suspicion that Senator Taft may have been right.

This complacency with orthodox theory is not built upon the record. Senator Taft believed so completely in the theory expressed by him that he led his forces against last-ditch opposition by the President until a very large tax cut was accomplished.

No disaster thereupon overcame the Nation. The inflationary movement was not aggravated. What actually happened was quite contrary to accepted theory. The postwar inflation, far more rapid and dangerous than that which we are now watching, was not fed by the tax cut. Indeed, it slackened very soon after the tax reduction occurred, and a moderate recession appeared. Then everybody was glad that the tax cut had been made.

The only disaster was to the economists. How could we square our theorizing with the fact that an existing inflationary movement was not aggravated by a substantial cut in taxes? And if tax reduction inspires business activity, how could the economy shift downward from a high level of activity immediately upon the cutting of taxes?

This was the first of three massive movements in the volume of Federal tax collections since World War II, and it should be noted that if it is difficult to find a definitive pattern in the effects of fiscal policies when large movements are available for study, our policy-makers need give little attention to theories which attribute definite effects upon the national economy to minor changes in the level or type of taxation.

The second substantial change was the increase in tax rates upon the outbreak of hostilities in Korea. Instead of causing a deep depression, the deflationary tendency of the tax increase was smothered in a war boom. Of course the economists have always recognized this exception to their general rule.

This economic exhilaration arising from war activity, by blanketing the depressing effect of a sudden heavy increase in the burden of taxation, permitted the economy to adjust itself to the type and level of taxation against the day when the business world would not have the impetus coming from active war operations. But the continued progress of the economy, with only temporary interruption, when active war ended points to this important rule, which should be placed first in the list of canons of fiscal policy. When the economy has adjusted itself to a type of taxation, it is better to stick with that type than to make a change which will in turn require new adjustment and will raise many unexpected problems. This rule is itself ground enough for rejecting the proposal that some kind of sales tax be substituted for a large part of the corporate income tax.

The third large change in the volume of Federal taxes was a reduction in 1954. This turned out to be on the eve of a renewal of growth of a hesitating national economy, and of renewed inflation of mild character. This was in full accord with the accepted theory. The important feature of this fiscal policy action was that the tax reductions were given to consumers, not to business, and the business world thrived.

Business had adjusted itself very comfortably to paying more than half its profits to the tax collector, and has maintained a high level of capital investment. Consumers have kept their disposable income comfortably ahead of the increase in prices. One must wonder how the very intelligent Secretary of the Terasury was led to his impetuous and colorful outburst about a hair-curling depression if we maintain taxes at the present level. The evidence is to the contrary. We may have a depression, but if one comes it is far more likely to be caused by the monetary policy which the Secretary supports than by high taxes.

My comments, suggesting that the Nation will continue on the road of prosperity whether Congress decides to continue present high tax rates or prefers to give some relief to the consumers, derive from a high regard for the infinite capacity of our vast economy to adjust itself to economic changes, however severe. The $6 billion to $8 billion changes in Government spending and in Federal taxes which we are now considering should be easily accepted by the present $400 billion economy if it was not even staggered 10 years ago when Government spending dropped $50 billion in 1 year and a budget deficit of about that amount was turned into a surplus.

This was truly a sensational performance, and if one is disposed to minimize it by pointing to such sustaining forces as the accumulation of unfilled wants during the war years, I would point out that this is second guessing which goes contrary to the universal opinion at the time that there would be a severe depression when war spending ended. It was this opinion which led to the enactment of the law under which this committee exists.

The postwar national economy has met with equal success the problem of adjusting to slighter changes, comparable in size to those under consideration. The export surplus dropped about $5 billion in 1948 and continued to slide. The rate of new capital investment fell off more than $9 billion in 1949. There was another large decline in Federal spending after the fighting in Korea stopped. If the economy ever hesitated under the impact of these shifts or of the multitude of less weight, it quickly resumed its expanding course.

There are countless combinations of changes open to our great economy as it adjusts itself to new conditions, and the economist is on dangerous ground if he thinks that he can guess just what combination will appear this time. He is on safer ground if he prophesies that the adjustment will be in the direction of expansion rather than toward deflation of the economy. He is supported here by our experience throughout the postwar period. Unhappily for those who are obsessed with fear of inflation, this experience seems to require the conclusion that the array of national policies for economic stabilization which has saved us from a great postwar depression has also given the economy a permanent and strong inflationary bias.

Senator DOUGLAS (presiding). Mr. Curtis, do you have any questions?

Representative CURTIS. Yes, Mr. Chairman.

On a subject of this size, it is hard to pick up and ask these in any sensible order.

Are we operating, Mr. Chairman, under the 10 minute rule? I presume we are, are we not?

Senator DOUGLAS. Yes.

Representative CURTIS. I think first I would like to get one thing straightened out in Mr. Tobin's statement for my own satisfaction, and then be sure that the rest of the panel are somewhat in accord:

Mr. Tobin made the statement:

> I shall examine the implications for monetary and fiscal policy of a reduction in Federal Government expenditures below the budget proposed by the President for fiscal 1958. I understand that the wisdom of such reduction is not the issue here, but I would like to make it clear that I do not regard the proposed budget as excessive.

I wanted to hit on that particular point, to be sure of what you are talking about.

You mean you do not regard the budget as excessive and possibly damaging to our economy, or you are talking substantively about the items that go to make up the budget, that maybe we need to spend the money? I wanted to be sure which way you were addressing it.

Mr. TOBIN. I was talking about the overall total in comparison with the total resources of the economy. I am not making a judgment about particular programs, whether they are the most efficient way to use Government funds or not.

Representative CURTIS. That is what I wanted to be sure; in other words, you are saying that in your judgment we can handle a budget that size with the economy that we have?

Mr. TOBIN. I would say that. We can handle a budget that size with the economy we have. But, of course, whatever size budget you have, you want it to be spent economically.

Representative CURTIS. Oh, of course.

But I wonder if there is agreement in the panel on that; that is, the Federal Government spending this amount of money in relation to the GNP, and whether that is something that this economy can bear.

Mr. BUTLER. Well, I would not argue that we could not handle it. I would argue that we are under strain to do in part because of a very high level of Federal expenditures. I think we can probably get by, but I think the behavior of prices indicates the fact that a condition of strain exists.

Mr. TOBIN. May I comment on that?

Representative CURTIS. Yes, certainly.

Mr. TOBIN. I am not speaking about the price or monetary systems, but rather about just looking at it in terms of the real resources that are available to the country. And if you look at it in that way, then you have to ask yourself: What are the uses to which resources would be put if they are not used by the Federal Government or by other governments for Government programs? And they are going to be used for expanding personal consumption of the country? We can always enjoy more consumption, and more leisure, but I think we have to admit that this country is pretty well off in that regard, and it could hardly be looked on in historical perspective as much of a sacrifice to the consumers of the country, for the Federal Government to be devoting these resources to national security and to other purposes.

The other thing would be the expansion of the productive plant and equipment of the economy, and there also we seem to be doing quite well.

The tendency for prices to rise, which Mr. Butler referred to, could possibly be countered at the same time that we have this size of Federal budget, by tightening the monetary screws a little tighter, if we wanted to. Or it may be that this is a built-in kind of cost and wage inflation, which none of these measures will touch anyway.

Representative CURTIS. I wanted to be sure that that was your position. I thought that was the statement. Because I think it has a direct bearing on this.

No. 1, my comment would be the very comment that has been made, that the inflation that we presently are experiencing would seem to derive some of its impetus from the Federal budget. Whether it does or not, I do not know.

But the second point, and the main point I would like to ask some questions on, is that this does depend economically on the present tax structure and taking the amounts of money that we are taking from the private economy. You would agree with that. In other words, we could not continue this high budget with any economic soundness if we did not continue at least the amount of tax take that we are imposing on the economy. You do not believe we could lower our revenues, our Federal revenues?

Mr. TOBIN. Essentially I think that is right. We could not lower our revenues veiy much. You have some leeway to lower revenues if one wanted to, countering that by a tighter money policy. I would not recommend that.

Representative CURTIS. Would you think that could be done? I would think that your inflationary forces would really then go out of hand.

But what I am getting to now is a statement that Mr. Clark made in reference to Secretary Humphrey's statement, which "led to his impetuous and colorful outburst about a hair-curling depression if we maintained taxes at the present level." I believe the Secretary was referring to over a period of several years. And what is his concern, and it is certainly my concern, is that our tax structure is actually eroding the very tax base, if our premise is correct, and if we continue this high rate we will continue to erode the tax base and actually might damage the very voluntary tax collection system which we have.

Most taxpayers laugh when that statement is made about it being voluntary, but I think most students of our tax system recognize that it is essentially voluntary. And most comments I have heard have been to the effect that the tax base is being eroded. In other words, with the high tax rate, more and more methods are discovered to avoid taxes, and also there is an impetus to actually evade them. Certainly in the Ways and Means Committee we see the constant pressures on us to create more loopholes in the tax structure.

Now, has this panel given any thought to the possibility that our tax structure might be damaged if we were to continue the tax rates we have?

Mr. HART. If I could speak to that, I think most economists who worry about these problems do agree that there is some tendency toward a deterioration of tax structures, as you say, and that substantial chances of improving the tax structure do seem to depend on being able to get the level down somewhat within the visible future.

Then we are also concerned somewhat about the curious distortions of incentives that one hears about.

I think we have to say that high tax rates are an evil in themselves, and if we could see our way to operate with a lower level of defense and a lower level of taxes, we would all feel happier about these tendencies.

On the other hand, I doubt that very many of us are afraid of a catastrophic slide within the visible future if we have to hold on at something like the present level.

Representative CURTIS. I will raise one point. Mr. Butler brought out this point to some degree, and I wanted to ask him this question.

When we had our hearings on the extension of the corporate tax rate of 52 percent, Secretary Humphrey replied that we were expecting an increase of only about a half a percent in our receipts from the corporate tax in the next year. And yet the anticipated growth, the GNP, was around 3 or 4 percent. And I raised the question as to whether that was not an indication that we were getting beyond the point of diminishing returns in that particular tax.

It is possible that we could be; although I have seen no studies on this subject, and in going back and looking at the tax receipts from the corporate tax, for example, when it was lowered and raised, and so forth, I could not see much relationship to increase or decrease of gross national product.

But would you have any comment as to whether you think there might be something sinister about an increase in GNP of about 3 percent next year with only an increase of a half a percent in the corporate tax take?

Mr. BUTLER. Well, I would regard that as a mistaken forecast.

Representative CURTIS. Would you? You think it ought to go pretty much with the increase in gross national product?

Mr. BUTLER. I think if GNP goes up 3 or 4 percent corporate earnings will go up 3 or 4 percent and corporate tax receipts will, too. I take the heretical view that corporate taxes are largely passed on over a period of time.

Mr. GEORGE. That is not heretical. That is just disputatious.

I might try to tie your two questions together, because I think they belong together. I do not think the republic is sagging because of this high cost of operation. But neither do I think that it is costless. And there is cost on both sides of the ledger, both with respect to expenditures and revenues. On the expenditure side, with rising expenditures we get an increasingly deteriorating allocation of resources. To put that in more vulgar language, the public gets less for its money.

On the tax side, all that I can do, and with some temerity, is to repeat a new law, George's law, that I enunciated in a meeting in New York 2 or 3 weeks ago, and that is that tax morals tend to decline in direct ratio at every level of income—and I have to consider changing that to geometric—to increases in the tax rates. And that efficiency of resource allocation, which is even more important, does not lag far behind. The higher we go, there are costs. This does not mean that our situation at the present time is precarious. We went through that sort of semi-comical worry, you will remember, in the thirties, when we got up to $4 billion. We were ruined. And I expect that any concern about the present level of taxes, as far as stark consequences are concerned, will follow that experience into the stale joke bin. But there are serious costs of rising percentage and resource diversion.

Mr. BUTLER. May I make one further point?

It seems to me that this bears on something Professor Tobin has said: that in many ways a dollar of Government spending may be more inflationary than a dollar of private spending. And I think it is particularly true in the area of defense, where you have in effect cost-plus contracts, where you bid up the price of labor, and particularly of trained manpower, in bidding it away from other producers. And thus I think you do something important in the way of contributing to the cost push inflation, which everyone talks about.

Mr. COLM. If I understood Mr. Curtis, the two questions really aim at one problem: Are we going too far in Government services and going beyond what the community can bear, and, particularly, are we impeding the growth of the economy?

I do not believe that I could, in any objective way, say that we do. Over the last 10 years we had a rate of Government expenditures, everything included, of between 15 and 21 percent of GNP. Yet, in the same period we had the greatest prosperity, and the greatest boom, we have ever had, as well as the greatest indication of business incentives, and consumer confidence, we ever had in any such prolonged period. And we are by no means at the top. Government expenditures now account for about 18 percent of GNP, which is somewhat in between the highest and lowest points during this 10-year period.

It is true, on the other hand, that we have very high taxes. And, if Mr. Curtis does not mind, I would like to modify his statement just a bit. Mr. Curtis asked whether those tax rates have not eroded the tax base. I think they have eroded the tax system, not the tax base.

We have the psychological fact that people do not remember each day the world conditions we are living in. There is still some of the "as usual" psychology even though we are almost in a war situation. People are inventing all kinds of tax loopholes and pressing for them. That is what we call tax erosion. And erosion places a heavier burden on those who cannot make use of those loopholes. As a result there are certain groups of people—perhaps they do not employ the right tax lawyers—who pay extremely high tax rates. I think they are in the unhappy minority. But we do have this deterioration in tax morale.

I think this is a very serious point. It was mentioned yesterday by somebody on the panel, and I made a statement on it today. Our view that we do not see an early chance for much tax reduction should not be interpreted to mean that there cannot be tax revision.

The Ways and Means Committee has begun working on this problem of the tax erosion and the unfair distribution which results from it. I think that some tax revision is in order, to stop what the Congressman called "erosion." That is erosion of the tax system rather than the tax base.

Representative CURTIS. I agree that tax system is really what I should have said.

Representative MILLS (presiding). Gentlemen, first let me get the consensus of the panel on the effect of appropriation reductions on actual Federal spending in fiscal 1958.

Dr. Colm says, along with others, particularly the staff of the Joint Committee on Internal Revenue Taxation and the staff of the Joint Economic Committee, that despite appropriation cuts that have been made so far by the Congress, and those that have been made by the committees and not yet passed upon by the Congress, actual Federal spending in fiscal 1958 will be somewhat greater than estimated in the President's message to the Congress in January of this year.

Have any of you made any detailed studies or estimates, other than Dr. Colm, of the possible effect of these appropriation actions on actual spending in fiscal 1958?

Mr. George, have you?

Mr. GEORGE. I did summarize my findings. They were based on assistance given me by the Budget Bureau as to the status of the different appropriation bills, but they, I have learned, would shun any responsibility for the conclusions that I reached.

But through the method I described in my formal statement, I came to the conclusion that the decline in spending below the President's budget on a constant dollar basis would be almost negligible, and that after allowance for price increases that we have to expect during the next year or year and a half, the increase in cash outlays over the budgeted expenditures would be at least a billion dollars; very probably more.

Representative MILLS. Mr. George, during the Joint Economic Committee hearings on the President's 1957 economic message, I asked the Director of the Budget, Mr. Brundage, about his estimates of Federal spending in the fiscal year 1959, taking him on beyond the 1958 fiscal year.

As I recall his statement, he expressed the hope that it might be possible to hold expenditures in 1959 to the levels estimated for 1958.

Do you have any estimates, or have you made any study, of possible Federal expenditures beyond the 1958 fiscal year?

Mr. GEORGE. Well, Mr. Chairman, I have not made any studies that I could dignify as a quantification of what might happen beyond fiscal 1958.

Representative MILLS. You cannot go beyond fiscal 1958?

Mr. GEORGE. Not in figures. I did try to identify some of the pressures that are at large in our present environment and reach a mental conclusion or impression as to whether or not they were such that we could overcome them, or whether they would be likely to carry spending further. And I am afraid that I did come to the conclusion that they would be very difficult to resist in a period beyond fiscal 1958. I rather expect that expenditures will still rise in fiscal 1959.

I could identify by programs a great many of the possibilities that entered into my calculations in arriving at this result, but I am afraid that might take more time than you would wish.

Representative MILLS. Of course, we must take into consideration that any estimates of today with respect to that period would of necessity be based upon many "ifs."

Mr. GEORGE. Yes, sir.

Representative MILLS. If, over the period of the next 5 years, say, we experience a continued growth in our economy, such as to provide full employment, and if we continue the present Federal programs, and if we are not successful in obtaining from Russia the impression of persuasive peacefulness, what may we expect in the way of Federal expenditures during that period of time of 5 years? Will these expenditures of Government, of themselves, go down, or will they continue to rise in a rising economy?

Mr. GEORGE. I am glad you chose that form of words, because I am sure they will not go down of themselves. I think it will take a very strenuous effort to hold them down.

I told you that I had quite an elaborate list of programs that I examined from the standpoint of their burgeoning potential inside the next few years, and I will not go through all the reasoning, but I will take advantage of your second question merely to list a few.

In the case of defense, the transition from conventional to modern hard-goods is, I think, bound to result, for a time at least, in a rise in defense outlays, quite apart from the fact that the increase in costs for military items has been far larger as to parts and subcomponents entering into them than anything with which we are familiar from ordinary references to the Consumer Price Index and the wholesale price index. And I rather suspect that that divergence will continue for at least a while.

There are many people who also think that we are becoming laggard a bit in the modernization of our weapons for peripheral and brushfire types of wars, and that expenditures on that account could rise in amounts that are not predictable.

On the civilian side, I can merely cite the following programs that carry great appeals: The schools, hospitals, college dormitories, highways, airports—a very large item there—harbors, flood control, irrigation, water supply and power, social security and public assistance, small business, depressed areas, residential construction, and slum clearance. Every one of these items has its powerful champions, and every one of them, in my own judgment, has its merits. There are some things that I would like to see added, Mr. Curtis, to our present burdens if I felt that the double type of progressive cost to which I referred would not be too great, and I know that other people would feel the same about other programs. So that unless a reversal in attitude shared by the public is convulsive, at the present I see no basis for a forecast that the expenditures within the next 2 or 3 years are going to decline.

Representative MILLS. Dr. Colm, do you have any comment with respect to either of these two questions put to Mr. George?

Mr. COLM. Mr. Chairman, I agree with the conclusion that Mr. George has reached.

I played around with those figures in quantitative terms. And I would say almost without much qualification in my mind that the 1959 budget will be above the 1958 budget by at least $2½ billion unless any one or a combination of the following things is done: First, a reduction in the strength of the Armed Forces. I do not mean any shifting around of funds, but a real substantial reduction in Armed Forces. Second, a real cutdown or slowdown in procurement. These are the only two conditions under which I could see that the increase in the national defense expenditures would not materialize.

You notice that even the apparently very sharp cuts the Congress has adopted in the defense budget, did not affect any of these conditions, neither the strength of the forces nor the quantity of procurement. With the programs now in existence—which have not been cut down by Congress—we can expect another increase in expenditures in the defense budget.

You will also notice that there are areas in defense which are not now fully developed—civil defense against the atomic threat, the defense against guided missiles, and the antiguided missile defense. In this whole area the experts believe that if we continue with, what I would call, a technological race, one step follows the other.

Second, in the nondefense field—in some of the areas which Mr. George mentioned—the pressure for greater expenditures is not only future pressure. It arises in part out of existing legislation, which will make for future higher expenditures. I have here figures for each of these programs which I submitted in testimony to another committee.

Thus, in answer to your question as to fiscal 1959, all indications are that there will be an increase in expenditures of perhaps $2 billion to $2½ billion if nothing really new is added.

We do know that revenues, under full employment conditions, have increased by about $2½ billion to $3 billion per year, which gives us perhaps a tiny bit of an increase in the expected surplus. But I would say that this difference is within the margin of error of any of these figures.

Now, with respect to the longer range outlook, Mr. Chairman, going beyond 1959, as I think your question did, I do not see why this technological race should come to an end in 1959. I do not know. But I do believe that we will run into the necessity of stepping up some of the nondefense programs. Perhaps we would be able to reduce some others, where, let us say, we have more political pressure than economic necessity. Among those areas that Dr. George mentioned, I would pick out the problem of the water supply. I think we are running into a critical situation, where our use of water for urbanization, agricultural development, and industrial production by far outpace the present development of water supply.

Thus there are a number of other activities, where it is not a question of whether we can afford it, but rather whether we can afford not to do these things if we want continued economic growth. These expenditures are essential to economic growth. It is hard for the Congress to select and push those programs which are an economic and social necessity and perhaps be tough on those where there is great sociological pressure but not the same economic and social necessity.

Representative MILLS. Do any of the members of the panel disagree with the general observations of Mr. George and Dr. Colm with respect to expenditures in 1958 and 1959 and possibly beyond?

Mr. HART. If I could comment, sir, I would like to introduce a difference of emphasis, which is not really a disagreement.

From a standpoint I was mentioning a minute ago, of privately financed deficit spending on Government account, this prognosis on defense spending, it seems to me, points toward pressure in the nearer, rather than the more remote, future.

For what it is worth, I do not take these budget figures too seriously—we entered the last fiscal year; that is, the one now going, with $37 billion of obligated authorizations unspent. The budget estimate for July 1 coming up is $40 billion, showing an increase of $3 billion, and, for July 1 following, a further $5 billion. This will be in line with the expectation that the commitments that are being made now, under existing legislation and programs, point toward an increase in Government expenditure at a later date.

We are visibly on the upgrade.

If you like, you see, this $40 billion or $45 billion is a measure of the cumulative effect—well, not all of this, of course, has been spent by private contractors on behalf of the Government, but a good fraction of this amount has already been spent—something on the order of a third to a half of it, or rather, more, if there has been a bulge in plant expenditure. The fact that there is a considerable change in the composition of the military hard goods would suggest also that Government operations are probably having a more stimulating effect on business plant expenditure than they would at a time when the composition was rather stable.

And it seems to me that while, in the last 2 or 3 years, this private deficit spending on Government account has been running roughly in the neighborhood of zero, it is very likely that it is going to go up again, and that the Government will be exerting more expansive pressure on the economy than one would think by seeing the expenditure figures.

The real cutting edge of this policy is the commitment by the contractor, the operation and investment, which takes place a good deal before the Government disbursement.

Representative MILLS. Does anyone else desire to add anything?

I take it, then, that there is general agreement with the statements made so far on these two questions.

Let me then pass to another question. And then I will recognize you, Senator Douglas.

Yesterday the panel agreed, I think, that there was enough inflationary pressure in the economy for the remainder of this year so that a small reduction in actual Federal spending in fiscal 1958, say, of $1 billion or $2 billion, which you do not think will occur, would not call for any easing in monetary restraints or tax reduction.

Now, let me put the question the other way. Would a modest reduction in taxes January 1, the middle of fiscal 1958, say of $1 billion or $2 billion, be a serious disturbance to economic stability, even if Dr. Colm's projections and Mr. George's projections, which all of you seem generally to agree on, about actual spending in fiscal 1958, are correct? In other words, what would be the situation if these projections are right as to spending, and if the Congress should, effective January 1, reduce taxes in some way so as to reduce estimated revenues by $1 billion or $2 billion for the fiscal year 1958? What effect would we have on economic stability?

Mr. HART. Mr. Chairman, may I say something which I think perhaps none of us have brought out as much as we would like to: I think practically all of us would agree that the basic standard for appropriate tax adjustment should be business conditions, and that to forecast Government expenditure is only one element in trying to figure out the future business conditions. And we know that economic forecasting is rather unreliable. It seems to me that we really ought to say that within a wide margin we do not know how much taxation will be enough for a period a year from now.

We would certainly say we are not far from an appropriate level, which I should say would mean we were within 4 or 5 billion on one side or the other.

If we are talking, of course, about a difference of $2 billion to take effect in this fiscal year we are talking about a difference of $4 billion in annual rate, because this would be applicable for only half the year. And that would not be chickenfeed.

It seems to me that looking ahead from here, we could not definitely state either that such a cut would be a disastrous error or that it would be a wonderful thing. Most of us would probably express the hunch that such a cut would probably be excessive, but it seems to me that unless we can design some sort of policy for feeling out the situation as we go along we are always going to be gambling, and we may always prove to have been seriously off.

Mr. Clark alluded to the tax cut of 1948. As I remember, this was effective at the beginning of 1949 for practical purposes.

Senator DOUGLAS. May 1, 1948.

Representative CURTIS. That was the effective date?

Senator DOUGLAS. The effective date. I have just checked up.

Mr. HART. There was a substantial dip, as I recall, at the end of calendar 1948, which would indicate a good deal of it took hold then.

In any event, the time span of ordinary tax legislation is pretty long. We have been saying we seem to be able to see where we are for the rest of 1957 and we can make some guesses for early 1958. In this case this is a very rough sort of a guess.

Representative MILLS. I am taking into consideration the estimates of revenues for fiscal 1958. Dr. Colm, you reached about the same conclusion that the staff of the Joint Economic Committee has reached, about the same conclusion that the staff of the Joint Committee on Internal Revenue Taxation reached, with respect to the possible surplus that we will have in fiscal 1958. Now, if on January 1, we reduce taxes in some way so as to reduce the expected revenues within that fiscal year by a billion, a billion and a half, or $2 billion, on the basis of your projections what I am concerned about is what effect we will have upon economic stability by doing that.

Dr. Colm?

Mr. COLM. Mr. Chairman, I would like to endorse what Mr. Hart said. We do not know what the economic situation will be. At yesterday's economic outlook session, there was some general agreement that economic activity has been leveling out, although there is a possibility of some increase at the end of the year.

Now, I was careful about the way I worded my statement. I said I would advise against an early legislative commitment for tax reduction. What I meant was that I did not want to prophesy that there would not be any ground for general tax reduction in 1958. I would only say that as things look today, I would advise against making a legislative commitment that a tax reduction should go into effect at a specified date. This is my position under the present economic outlook as I see it. I think we ought to be prepared, as Mr. Hart said, to change our advice the moment conditions change.

Second, when you asked about 1 or 3 billion tax reduction, there I must agree with Dr. Clark and others. That amount of tax relief is within the margin of error in a $400 billion economy, and you may say it has little effect. Speaking as an economist, I would say it would be a move in the wrong direction as things look today. Congress may decide that we need tax reducton, because of social pressure—to give relief to some people. There are other objectives of Government besides the best possible fiscal policy. I have advocated certain increases in expenditures though not strictly on fiscal grounds. Dr. Tobin said that if we have some small tax reduction at the wrong time, we could make up for it by more strigent credit policy. However, that approach in my judgment would be under present conditions the wrong combination of devices.

Credit policy, as things are in our economy, has a very selective impact, particularly on construction, on small business, on farmers, and so on. Tax policy, because of our present very wide distribution of taxes, has a much more general effect.

I do not think we are in a situation where we have generally excessive demand. I do not agree that our inflation is of that type. We have, however, a pretty satisfactory demand situation.

But we do have specific deficiencies. We have a deficiency in residential construction. We have the problem of depressed areas. We have the farm problem. We have specific spot situations. I believe that credit policy is better suited for dealing with that sort of thing. For example, Dr. Newcomb yesterday recommended measures for channeling credit into the construction industry.

Therefore, I would for a while hold out on tax reduction. I would rather be somewhat more liberal on the credit side, because it has a more selective impact.

Representative MILLS. Now, on the basis of the estimates you made, and to which all of the panel seem to have agreed, with respect to spending in 1958, and on the basis of estimates of revenue which our best sources for such information have made available to us, my question may contemplate the creation of an unbalanced budget in the fiscal year 1958. And it is that point that I am thinking of when I raise the question of the possible effect of such a reduction in taxes on economic stability.

Now, I think, Mr. Butler, you have already covered the point somewhat in your general statment. Is there anything that you would like to add?

Mr. BUTLER. Well, first I would like to make a point that is somewhat off your question, but I hate to have people run down the ability of business forecasters, since I am in that business. I think we have done pretty well in the past few years.

Now, it seems to me if we cannot balance the budget with the business outlook as good as it is for 1958, we are sunk in the long run.

Representative MILLS. Economically and perhaps some other ways?

Dr. Clark, do you have anything you want to say on this point? Or any of the other members of the panel?

Mr. CLARK. I think, Mr. Chairman, you were called out before I concluded my statement.

Representative MILLS. I had to answer a call from a constituent. You know in our State we have been having a surplus supply of water recently, and it all had to do with that.

Mr. CLARK. I ended by committing myself to the view that under our many new national economic policies to stabilize the economy we are now definitely committed to an inflationary type of an economy. So if we were to cut taxes, it would still be true that we will have an inflationary type of economy.

Now, would a tax cut of the small amount you suggest create larger inflationary pressures than would exist without that much of a tax cut?

In my position, after watching this for a number of years, in an effort to make business forecasts, my conclusion has been that these amounts that we have talked about are too small, in our big economy, to bring about an assured change that you can forecast. Other things are always happening. And I would point this out: the inflationary movement we have had in the past year or two has disturbed Mr. Douglas and others because some of the inflationary conditions alluded to do not seem to have existed. And yet inflation has been here. That is because there are other events and changes in the economy that are responsible for the inflation and not the ones that we usually look for. A good many analysts believe that what has been responsible lately for inflation has been what they call the wage-price squeeze, the increase in wage rates entering costs of production and bringing about an increase in prices.

Now, if there were a cut in consumers' taxes, which is the place it ought to happen, it is entirely conceivable that that situation, improving the position of the wage earner, would make it possible for industry to withhold easy assent to new wage demands, which in the aggregate would amount to a good deal more than this 1 or 2 billion dollar tax cut that you are talking about in its effect on the total economy. You just do not know.

But the only point I can make is: Do not attribute specific economic effect to these small changes in areas of our national economy.

Representative MILLS. Senator Douglas?

Senator DOUGLAS. Congressman Curtis asked questions which go to the heart of a good many of the problems. I shall content myself with some peripheral issues.

I would like to ask Mr. Colm about his reference to the possibility of economies on the procurement of military supplies, and I wondered if that was a general comment that you had or whether you have made some specific studies about how the cost of military procurement could be reduced without the damage to military security.

Mr. COLM. Senator, I must have been misunderstood. I meant to say that a real substantial economy could only result from a reduction in the targets in quantitative terms.

I do agree with what one of the panel members, I think Mr. George, said: that we are, in the case of a large procurement items, in a very unfavorable cost situation. We have very keen competition among firms before a contract is let or even before an intent is indicated about placing a contract. But once a firm gets a contract for a particular type of missile or a specific type of plane, then for all intents and purposes the job is theirs. I have not studied this recently, but during the war a number of different proposals were made to encourage incentive pricing. Yet I wonder whether there might still be some possibility of introducing an artificial substitute for the lack of competition which we have after the contract has been let. But that is the only comment I can make.

Senator DOUGLAS. You have touched on a very important point. Because the Air Force, as we all know, places nearly all of its orders in negotiated contracts, with a relatively small number of firms. And the question then comes as to whether these supplies are really competitively priced and whether large profits are later recaptured by the Government. Have you formed any conclusion on that point?

Mr. COLM. Well, I would say that there are numerous indications that the firms which have major contracts are doing pretty well. That is reflected not only in profit statements but also in some types of expenses which are made in connection with the government contract but which are for the benefit of the firm in general.

Senator DOUGLAS. You mean expense accounts are liberal in these cases?

Mr. COLM. Yes. For example, advertising want ads for scientists, and so on, which are charged to these specific contracts, probably benefit the firm in general.

Senator GEORGE. Do you have any constructive suggestions as to how these surplus payments could be reduced?

Mr. COLM. No, sir. I do not know of any one formula.

Senator DOUGLAS. Have you given consideration to the Air Force buying parts directly from part suppliers rather than giving contracts to the prime suppliers and letting them subcontract out?

Mr. COLM. I have given no thought to that.

Senator DOUGLAS. Have you given any thought to the question of common purchase and storage of common use item in the services?

Mr. COLM. Not recently.

Senator DOUGLAS. Do you know of anyone who has made any inspection of Government warehouses to see whether they were stocked with large quantities of material which are either obsolete or which exist in large quantities while current purchases are being made of the same items?

Mr. COLM. I had no opportunity for that.

Senator DOUGLAS. I think this a very large field for investigation. I have been in some Government warehouses, and I have been struck by the abundance of material which is there, which apparently has been there for a long period of time.

Mr. Tobin, I would like to ask you a question, if I may.

In your paper, you seem to lay almost exclusive emphasis upon stimulating investment, and you rather disparage any tax or other policies which would increase consumption, largely on the ground which you state on page 2, that—

> Present consumption levels for the bulk of our population must certainly be regarded as highly satisfactory in the perspective of our own past and the rest of the world's present and future.

Now, this may well be true of middle-class America and upper-class America, but I wonder if we sometimes leave out of account the fact that there is still a very large proportion of our population which has very inadequate incomes, as our studies of low income families show.

Twenty years ago almost precisely, President Roosevelt said that one-third of the Nation was ill-clothed, ill-housed, ill-fed. And as the income studies came in, that turned out to be something of an understatement, as a matter of fact. It was nearer three-eighths or two-fifths.

Now, the income studies which we have made seem to indicate that the proportion has diminished, fortunately, but that it is still approximately from one-quarter to one-fifth below a minimum of comfort and in many cases below almost a physical subsistence basis.

Now, in view of that fact, would not tax measures which would increase the consumptive power of these low-income groups in the population, (*a*) increase their efficiency, through greater expenditures on health and food and better housing and clothing, which are presumably productive expenditures, and (*b*) increase the sum total of human satisfactions which should be the aim of life, and not merely the material accumulation of goods? And therefore in tax policy, should not a great deal of emphasis be laid on the reduction of excise and sales taxes if decreases come, that is, and upon the reduction of taxes in the low-income brackets?

Mr. TOBIN. I agree with that, Senator. I think if you could distinguish the question of the distribution of consumption between persons of various income levels and wealth levels from the question of the distribution of the national output between investment as a whole and consumption as a whole, I certainly would agree.

Senator DOUGLAS. But you would not be opposed to selective decreases in taxes which would build up consumption in the lowest income group?

Mr. TOBIN. Not at all. I would also add that some of the ways of improving unsatisfactory living standards that you mentioned would be public expenditures for housing and for education.

Senator DOUGLAS. I am very glad you said that, because that was going to be my next question, as to whether public outlays for health, slum clearance, and housing, are not really extremely productive in greater national vitality and in the quality of life, which, after all, should be the aim of economics. Economics is merely a means. It is not an end.

Mr. TOBIN. I think that this kind of increase in public expenditure is an urgent need for resources, and much more urgent than any sort of across-the-board increases in consumption for everybody.

Senator DOUGLAS. I am very glad you have said that. And I hope the press takes due notice of that statement.

Mr. Hart, I would like to ask you a question if I may.

On page 4 you throw out the suggestion that you wanted some ways to be devised in which tax cuts could be put into effect at short notice.

Now, I have decided that for a long time, but I have been somewhat baffled as to how to do it, and I wonder if you have any concrete suggestionss aside from the general advice.

Mr. HART. Yes, sir; I think I can talk to that point. I would like to preface it, though, with one reservation along the line of what Mr. Colm said about monetary policy—that it would be desirable to have a very broad base mechanism of this sort. And what I can think of is, unfortunately, more sharply focused than I would like; namely, it seems to me the place at which it is possible to take rather quick action is the withholding aspect of the personal income tax.

You may remember in 1950, I think largely at the instance of your committee, there was a change in withholding rates effective October 1, particularly with advance preparation.

It is possible, I think, without undue friction in the machinery, to change the withholding rate effective at any quarter date. (I would be inclined to say though that monthly changes are scarcely possible.) The difference between quarterly or even semiannual changes and annual changes could be quite important in the timing of economic effects, I think.

Now, if you think of the personal income tax in terms of changing annual rates, as the primary thing, you can get into quite a mess. But it seems to me this again was clarified by the change made in 1950. If you think in the first instance in terms of the withholding rate, and then later in terms of how you would change the annual rates, declaration arrangements, and what not, to bring them in line, it seems to me it is always possible to design an orderly procedure for setting the annual rate.

If, for instance, you had a withholding arrangement under which, let us say, a 20 percent rate was in force for one-quarter of the year, a 16 percent rate for one quarter, and an 18 percent rate for two quarters, then you would settle the annual rate 2 percent lower than the usual rate corresponding to 20 percent withholding.

Senator DOUGLAS. Would you have these changes go into effect automatically on the movement of business indexes, or the decisions of Congress?

Mr. HART. It would seem to me the difficulty with the speed of action is largely the complexity of the problem raised when you get a general tax reduction. On 2 or 3 occasions we have had rather quick congressional decisions. This happened also in World War II.

In each case the structure of the tax was regarded as established. But the question was: On what scale should we apply the structure? Should we produce an across the board change of a certain magnitude? To focus the issue, suppose, for instance, you had set up in advance three possible withholding systems, and the question was: Shall system A or B or C be in force for the next quarter? This is the kind of question, that can be dealt with with reasonable promptitude, because it focuses sharply on a rate-level only. The question whether we should reconsider the whole tax structure for next quarter is a hopeless question. The whole system of congressional hearings linked with the public's right of petition and what not would say that you cannot do that sort of thing without giving due notice to a lot of people and seeing how they react.

It would seem to me if advance thought was given to the question, "What kind of alternatives might be set up in advance?" the question of which alternative to apply at a particular period need not yield a long drawn out debate. I would say there was time for action between the time you found out as to business conditions in the October–December quarter, and the time when rates of withholdings for an April–June quarter must be finally set.

If you made changes semiannual, there would be even more time turn around.

Relative to the habit of trying to decide about the time of year what tax rates should apply to a calendar year beginning next January, it seems to me my proposal offers quite a gain in the possibility of adapting taxes to business conditions.

Senator DOUGLAS. This is very appealing, and I hope it will be true, but generally human nature is such, and we share in human nature here, that we make changes only when some real and sharp emergency is recognized and is upon us, such as the outbreak of the world war, the conquest of the lowlands in France, or the Korean war.

But where you have slow economic changes, people are very reluctant to recognize them. As a matter of fact, for a long time the Treasury and the administration refused to admit that there had been a recession in 1953–54, and my head is still bloody from the bludgeoning they gave me for saying there was a recession.

Now I am interested in seeing that after the fact you gentlemen all agree there was a recession in 1953–54. But during that time the existence of the recession was denied. And if it is denied, then you would not adapt policies to meet it. Now, do you have any way of getting a greater sense of reality into the mind of the Secretary of the Treasury and the President and his advisers, and willingness to face situations? Have you some magic truth pill that you could give to people so that they would tell the truth?

Mr. HART. Well, Senator, I would like to agree with Mr. Clark that there is no use trying to be too supersmart in these things. The idea of tuning small changes in taxes to have small changes in economic conditions would, if anything, splinter the public attention that should be focused on the big issues rather than really get things done. It seems to me what we are concerned with here is setting up a standby arrangement which could be used in case we had a really rapid dropoff.

Senator DOUGLAS. I was going to say that is the consequence of not only a rapid dropoff but a very large dropoff. And by that time, by the time that has happened, it may be too late. Is that not true?

Mr. HART. Well, again, if we were cooperating in a situation where the public was full of fear about the basic workability of the economy, which was actually the situation at the end of World War II, the catastrophe hazard would be somewhat greater. It seems to me we are operating at present in a situation where people have had very favorable experience. If we got a serous dropoff, people would be thoroughly prepared to believe in the possibility of putting things back together rather soon, and consequently we would have a few months to turn around before people went into a mood of despair if we were able to do something about it in the meantime.

Senator DOUGLAS. Mr. Chairman, I want to make one final observation. It may stir up the lions, here. But it is my general impression from the testimony of these people that if we do not do very much it does not matter what we do.

Mr. HART. Could I comment on this, Senator? I think this is a very just summary of the way we have sounded, but I doubt if it is a very just summary of what we really meant.

Senator DOUGLAS. It is what it sounded like.

Mr. HART. Yes, sir; I agree to that. It seems to me that relatively small changes are not very important if you are somewhere pretty close to the target. On the other hand, if we were already 10 billion off, to go another billion in the wrong direction might be rather serious. There is a general presumption that when you are very close to right you can afford to be a little less right, but if you are already quite wrong it may be serious to be a little more wrong. And actually, we are operating in a context where we think we are moderately close to being right, and, therefore, we are not much concerned. If we thought we were far off, we would be talking in a different tone.

Representative MILLS. Mr. Curtis?

Representative CURTIS. I was interested in pursuing this thought a little further on the inflation that we are presently experiencing, and I think it was Mr. Clark who commented that the causes of this inflation were not the usual or traditional ones.

You suggested that a wage-price squeeze was one of the factors. I think it is quite important that deeper analysis be made of what is producing this inflation.

First, might I ask this: Is it generally agreed that we are going to continue to experience further rise in the cost of living? Did that come out yesterday at all, Wilbur?

Representative MILLS. To some extent.

Representative CURTIS. I wonder what your view is as to whether this inflation will continue and at the same time what, in your judgment, lies behind it?

I might comment, myself, that it seems to me that maybe not the rate of Federal spending but certainly the kind of Federal spending has a direct bearing on the subject, and another thing that I think has direct bearing on the subject is the cost of money. That is, investment capital. And that goes into the cost of goods, it seems to me.

This becomes important, because in our military budget, which we just recently voted, they said a good bit of the money that we voted them, or a portion of it, would be eaten up through the increased costs solely from inflation. If this is going to be a spiral, it becomes very important.

Yes, Mr. Colm?

Mr. COLM. I would like to support Mr. Clark's statement that the type of inflation we have is not exactly the kind about which we have been reading in our textbooks. Nor do I think that the devices for fighting inflation which are usually recommended are most effective for the kind of inflation which we have. There is a distinction between demand inflation which results from excessive claims against scarce resources, versus what has now been called the cost push inflation.

I believe it is almost commonplace to say that these two things occur always in a certain combination. We can only indicate where the primary origin was. The origin has been, in part, on the cost side, but, of course, prices could not rise without creating serious unemployment if purchasing power had not followed suit.

But at least some part of our inflationary situation originates in a cost push. I hasten to add, however, that excessive wage rates are not necessarily the prime cause.

We speak of the price-wage or wage-price spiral. There is a considerable area in the economy, particularly in the military procurement field, where we have—what we call—administered prices. In these instances the price level does not quite reflect competitive price formation. And I think it is rather futile to speculate whether the rise in wages or the rise in prices came first. We know that both have moved. We know that we have cost increases which are translated into the whole price and demand structure.

This is an area which, in my judgment, deserves most serious attention.

I was very happy when I read in the Joint Economic Report issued by this committee that attention was drawn to that very point. It deserves more study.

I think that the classical device—restrictive tax and credit policy—is not very effective for this problem. Some economists say that since this is not effective and since we are moving at somewhat below a full level of employment and production, let all restraint go. I would not draw that conclusion. In fact I think it is a very dangerous conclusion, until we have devised a proper policy for dealing with that situation. We do not have such a policy at the moment. Instead we have to use the less effective device of credit and fiscal restraint, even though we know it means that we cannot push as vigorously ahead with measures supporting economic expansion as we could if we had a proper stabilization policy.

At this moment I do not know the exact means which could be used for effective stabilization. I say that as a challenge to my colleagues, because if any one of them knows the answer, I hope he will give it. Only after we have a more effective means for dealing with the price and cost situation can we make full use of fiscal and credit policies in a constructive manner to support economic growth.

Representative CURTIS. Well, Doctor, if there is a shortage of investment capital, which it seems to me is quite clear, there you do have the traditional situation there of excessive demand with insufficient supply, I wonder just how much that competition for investment capital might be entering into this. I know in certain fields, let us take the savings and loans, in order to get your money you have to go up to 3 percent. I expect the same thing is reflected, say, in the earnings of a common stock. They find that in order to retain or gain new capital they might have to increase prices so that they can attract more capital. I do not know that this is so, but it would seem to me that that might be a real ingredient, here. I do not know how big a factor it is.

That was all I had, unless someone else had a comment on that.

Mr. TOBIN. I would comment on that, if I may, that people who find it more expensive to borrow money may be tempted to wish to increase their prices in order to offset the increased cost of borrowing.

But the question is whether they will be able to do so and still maintain their sales. And it does seem to me that the deterrent effects of the high cost of borrowing or tight money, in keeping people from borrowing who might otherwise have been able to get their hands on money to bid for houses and labor and other resources, would probably make it impossible for people to pass on the extra interest costs. They just would not be able to sell it.

Representative CURTIS. I know they pass it on in the savings and loan field. That is one I am a little more personally familiar with. And I imagine certainly if it is competition wherever it goes, it would have to be passed on. It is a cost of doing business, even though it is competition for equity capital.

Representative MILLS. Each of you will have permission to insert such additional data as you have with you that you think will contribute to our understanding of these problems.

We thank each of you for your appearance this morning and the valuable statements you have made.

The committee will adjourn until Wednesday at 10 a. m., to meet in P–38, which is the Senate District Committee hearing room just off the floor of the Senate.

The committee stands adjourned.

(Whereupon, at 12:25 p. m., the hearing was adjourned until 10 a. m., Wednesday, June 5, 1957.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

WEDNESDAY, JUNE 5, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to recess, in room P-38, the Capitol, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Representatives Mills (chairman of the subcommittee) and Curtis.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy, and John W. Lehman, acting executive director.

Representative MILLS. The subcommittee will come to order.

This is the third day of the subcommittee's hearings on fiscal policy implications of the economic outlook and budget developments. The purpose of these hearings, as previously announced, is to bring into clearer perspective the economic considerations which must go into responsible fiscal policy.

The subcommittee has met this week with two panels of distinguished economists—on the first day discussing the economic outlook through 1958—and, yesterday, considering effects of appropriation actions thus far this year on actual Federal spending in fiscal 1958.

Today we are meeting with another group of eminent economists to explore the relative emphasis which public policy should seek in the interests of continuing economic growth and stability as between investment and consumption. Since we are concerned also with changes in Federal spending we want to look into the possibilities of Federal fiscal actions which would permit State and local governments to assume greater responsibility for meeting demands of a growing population.

We will hear the opening statement of each panelist before proceeding with a general discussion.

Our first witness is Prof. Walter W. Heller of the School of Business, University of Minnesota. Professor Heller, it is a pleasure to have you with us today. You are now recognized.

STATEMENT OF WALTER W. HELLER, SCHOOL OF BUSINESS, UNIVERSITY OF MINNESOTA

Mr. HELLER. Thank you, Mr. Chairman. I should like to present my comments directly from my prepared statement.

My comments today will be directed, first, to the necessity of gaging not merely the size but also the economic character of a prospective

93528—57——8

budget surplus before deciding whether it provides a sound basis for tax cuts; second, to means by which Congress can improve its fiscal timing through a broader use of "on the shelf" tax reductions like those scheduled for the corporate income tax and certain excise taxes; and, third, to some considerations bearing on the type of tax adjustments that should be made when leeway for cuts develops, with special emphasis on alleviating the intense fiscal pressure on State and local government.

To know that the budget is running, or about to run, a sizable cash surplus is not a sufficient basis for advising the policy maker to turn on the green light for tax reduction. Surpluses, after all, can be used for many purposes: (1) To fight inflation, most effectively by retiring Federal debt in the hands of the Federal Reserve System; (2) to reduce the Federal debt held by the public; (3) to provide tax cuts, either for consumers or business, or both; (4) to provide Federal aids, sharing arrangements or skillfully structured tax cuts to aid State and local government; or (5), an alternative that may be ruled out of order in the present atmosphere, to expand Federal programs.

Whether a surplus should be impounded to fight inflation or released in the form of tax cuts depends on whether it is a "constructive" or "destructive" surplus. Just as a deficit is constructive in the face of recession and unemployment, when it serves to pump financial plasma back into the thinning economic bloodstream, so a surplus is constructive in the face of inflation and overemployment when it serves as a tranquilizer for an overstimulated economy. And just as deficits are destructive during inflations, so surpluses are destructive when the economy needs a stimulant to avoid recession or a slackening in the pace of economic growth.

What does our economic radarscope tell us on this score with respect to our present cash surplus of about $3 billion? Present readings clearly indicate that surpluses now are constructive, that they help hold inflation in check. But if our economic pace should slacken—if productive capacity should outstrip consumption more generally instead of primarily in autos, housing, textiles, and some consumer durables—then they would become destructive. Unless eliminated by tax cuts or increased spending, or offset by an easier monetary policy, they would hold economic growth in check.

Although the overall economic situation determines whether a budget surplus is destructive or constructive, the way in which it is generated may provide some clue as to the appropriate fiscal action. For example, if it is generated by budget cutting or gutting, it may well be destructive, something to be stamped out by prompt tax reduction so that the cutback of Government demand won't interrupt economic growth. If, in contrast, the surplus is generated by inflationary expansion of revenues (which may outpace the inflationary expansion of expenditures, especially early in the course of an inflationary development), it is likely to be a constructive force in economic stabilization policy. If, finally, the surplus is generated by steady, noninflationary growth in employment, income and tax revenues without a corresponding growth in Government spending, it is likely to become a retarding, destructive force in the course of time.

I want to turn now to the timing of tax reductions.

Although net tax reduction seems inappropriate at this time, it may become appropriate and necessary next year to keep the economy on a steady upward path. Since economic changes can be very swift and since the congressional taxing process tends to be slow unless it is operating under extreme pressure (as after Korea), Congress should be on the alert for methods to improve the timing of its tax actions. As a matter of fact, in recent years the Congress has, perhaps unknowingly, added a very useful new tax tool to its kit of fiscal stabilization devices. I refer to the "automatic" or "scheduled" reductions in the corporate income tax and certain excise taxes, that is, those on liquor and tobacco. In setting automatic expiration dates for some of the tax increases enacted in 1951, the Congress in effect created a "shelf" of tax reductions much like the "public works shelf" often urged as an antidepression measure.

I suppose this analogy isn't entirely complete because these tax cuts fall off the shelf unless the Congress pushes them back up, while the public works projects stay on the shelf until pulled down. It occurred to me you might think of them as "tax cuts on the half shelf."

The conscious development of a broader program of "on the shelf" tax reductions has much to commend it. When inflation threatens, the cuts could be postponed, kept on the shelf, as they have been in 1955, 1956, and 1957. But if economic recession or a slowdown of economic growth faced the country, Congress could pull the tax cuts off the shelf or let them come down on the specified date. This would greatly shorten the lag between an economic downturn and positive tax action to counteract it.

If Congress were to follow such a policy, it would undoubtedly want to improve the product mix of the tax cuts put on the shelf. For example, it would very likely prefer a different set of priorities in excise tax reductions, perhaps putting such taxes as those on communications and transportation higher on the tax-cutting agenda than the ones which are now scheduled to drop. Perhaps the most difficult, and yet the most urgent, segment of the tax reduction package is in the individual income tax field. Even though a cut would be inappropriate now, the terms of a balanced tax reduction could be worked out and put on the shelf side by side with the corporate and excise tax cuts scheduled for mid-1958. Congress could tackle the job of working out the terms of a tax reduction this summer, and thereby gain valuable time. It would then have a swift and potent weapon on the shelf to counter economic slumps or to cope with the less likely eventuality of sizable disarmament.

In passing, one may note the attractions of the June 30 as compared with the March 31 expiration date. By mid-year, Congress has the current year's budget picture well in hand and a good line on appropriations for the following year. Moreover, having had time to test and revise the usual crop of year-end forecasts, the Congress would be in a well-informed position either to let the tax cuts drop off the shelf to help offset a softening economic situation or hold some or all of them on the shelf for another year to keep up our guard against inflation.

It may be argued that personal-income-tax cuts could not be kept on the shelf, politically speaking, even in the face of inflation. Political pressure would win out over inflationary pressure. But it seems to me there is considerable evidence of congressional courage and taxpayer intelligence to contradict this argument: (1) when they clearly saw the need, Congress and the taxpayers accepted $15 billion of new taxes in the 15 months after Korea; (2) the Gallup poll has time and again come up with a strong voter preference for debt reduction over tax reduction; (3) not so long ago, a President was unexpectedly reelected after twice vetoing a $5 billion tax reduction; and (4) the history of our three major tax reductions since World War II—in 1945, 1948, and 1954—shows that in each case the party in power when the cuts were made lost control of Congress in the next election.

I turn next to the nature of tax adjustments that may be appropriate.

No doubt, my colleagues on this and other panels will deal with the question of emphasis on expansion of consumption versus expansion of investment as the focus of fiscal actions for stability and growth. I should like to address my remaining comments to the State-local stake in any tax leeway that develops at the Federal level.

In our national preoccupation with Federal budget woes, we seem to have lost sight of the dramatic postwar resurgence of State-local government. Since World War II, State-local spending and debt have more than tripled, and taxes have more than doubled—with expenditures rising from $12.5 billion to $40 billion and debt from $16 billion to over $50 billion—and taxes have more than doubled from $13 billion to $33 billion. In the last 4 years, State-local spending has jumped by an average of $3 billion each year, in contrast with Federal increases averaging less than $2 billion annually. The percentage increase in State-local spending during the 4-year period has been more than double the rate of increase in Federal civilian spending.

So, by almost any index we choose, State-local government emerges as one of our most ebullient growth industries since the war. It supplies the kind of products demanded by a rapidly expanding population in a period of relative peace and absolute prosperity. People want more and better education, mental and physical health programs, roads, water systems, recreational facilities, and the like. Localities and States are the traditional sources of supply of these products. So it is small wonder that they are suffering severe growing pains and face the necessity of raising their tax rates by at least $1 billion each year over the next decade.

Yet, although our tax laws have shown very considerable solicitude for private growth industries—e. g., through accelerated depreciation and 5-year amortization, capital gains privileges, percentage depletion—little weight has been given to the hard-pressed position of State-local government. In fact our present Federal tax and monetary policies seem to be rigged against the vast public investment needs of State and local government. Preferential tax treatment has helped business to keep feeding the capital boom with internal funds derived, in part, from tax reliefs or interest-free loans from the Government. Secretary Humphrey testified just a few weeks ago that the Government will have to pay out over $3 billion in additional interest over the life of the 5-year amortization program; one may assume that this much or more is correspondingly being saved by the benefited businesses. These tax-favored funds largely escape the pressure of high interest rates and tight money. But public construction feels the full impact of tight money, in fact, doubly so because upper-income groups seem to be reaching the saturation point in their holdings of tax-exempt municipals.

What can Congress do in the tax field to alleviate the tremendous strain on State and local financial resources? First, if a decision is made to "spend" budget surpluses in the form of tax reductions, one may earnestly suggest that the administration and Congress add to the three traditional criteria of tax adjustment—equity, economic improvement, and ease of administration and compliance—a fourth criterion, namely, the maximum contribution to State and local fiscal capacity.

This contribution will be greatest when it is beamed directly at the tax bases which are readily available to State and local governments. Examples of "directional tax cuts" are the excises on amusements, cigarettes, and local telephone service. Though these taxes hardly qualify as "good" taxes under equity and economic criteria, this much can be said: if they must be used, why not give priority in their use to governments which have only limited access to better sources? Cuts in the lower brackets of the individual income tax also have a considerable directional quality. On one hand, they directly expand the tax base and revenues of the 20-odd States whose income taxes allow deduction of Federal income taxes in arriving at State taxable income. On the other, they leave room for rate increases either in State and local sales taxes or in the lower brackets of State or municipal income taxes.

But one should not make the mistake of equating the tax-reducing capacity of the Federal Government with the tax absorbing capacity of State-local government. The Federal Government has vast advantages in tax-gathering. It has broader geographical jurisdiction, better-financed and more efficient tax administration, freedom from the fears—both fancied and real—of intercity or interstate migration of industry and wealth, and other advantages. It may well be that we prefer to give up some equity and efficiency in taxation in exchange for more self-sufficient, vigorous, and responsible government at the State-local level. Up to a point, our choice may be for a more vibrant State-local government in preference to a more virtuous tax system. But the scope for this kind of exchange is bound to be rather limited under modern conditions.

Leaving aside Federal aids, we are brought to a second possible use of budget leeway on behalf of the States and localities, namely, a direct feedback of Federal tax collections. Congress should give careful consideration to methods of sharing its relative revenue abundance with the States and their subdivisions without at the same time impairing their autonomy. Direct sharing of income taxes would be one possibility, one that is certainly preferable to Federal tax credits in a tax field from which many States are barred by constitutional restraints. Sharing on the basis of origin of collections would probably be unwise on two grounds: (1) origin is difficult to determine; and (2) revenues are heavily concentrated in centers of wealth and finance. A straight per capita sharing system, not necessarily tied to the income tax, might be the easiest and least controversial method of putting a goodly share of Federal budgetary leeway, if any develops, at the disposal of the States.

The foregoing quick review suggests that tax reduction involves just about as many dilemmas, pitfalls, and hard decisions as tax increases. My remarks have been addressed to the (1) whether, (2) when, and (3) how, of tax cuts. My answers, in brief, are: (1) no, not now; (2) put a tax-reduction program on the shelf for easy and quick action when the economy slackens; (3) in whatever is done, give the fullest possible hearing to the financial plight of State-local governments.

Representative MILLS. Our next panelist is Prof. William J. Fellner, department of economics, Yale University.

We are pleased to have you with us this morning, Professor Fellner, and you are recognized.

STATEMENT OF WILLIAM J. FELLNER, DEPARTMENT OF ECONOMICS, YALE UNIVERSITY

Mr. FELLNER. Mr. Chairman, I believe that the problems which we must be prepared to face in the near future cannot be properly understood unless we first place them in a long-run perspective.

If in the long run we can continue on a path on which aggregate output is rising appreciably, then there will be room for graduate tax reductions in small steps, unless the international situation should call for devoting a rising proportion of the total output to defense. Assume, for example, that we shall keep the proportion of the national output which we are devoting to defense constant and that in the long run the sum of interest-on-the-debt, veterans' benefits and agricultural subsidies will be rising in a lesser proportion than output (or will not be rising at all).

Then, in the long run, we can afford to raise the average of all other nondefense items in the budget at the same rate in which output rises, and we will still have a gradually rising budgetary surplus. This is because Federal revenue at given tax rates tends to rise in a somewhat higher proportion than output, and because on the foregoing assumptions part of the Federal expenditure, namely, the sum of interest, veterans' benefits and agricultural subsidies, rises in a smaller proportion than output, or does not rise at all, while defense spending rises in the same proportion as output as a whole. It may not be too optimistic to expect that in the long run output will be growing at an average yearly rate of 3 percent to 4 percent, let us hope more nearly of 4 percent.

On these assumptions the average yearly increase in the budgetary surplus, with constant tax rates, might come close to $1 billion in present prices. This means that in years in which there exists no inflationary pressure, such as would call for further increasing the budgetary surplus, we could reduce taxes by almost 1 billion. Deflationary periods may justify much greater temporary tax reductions but I am concerned here with what might be called the normal growth path of the economy, not with measures appropriate to severe cyclical swings.

As the economy grows gradually, all tax rates could be reduced in small steps and exemptions could be increased. But if we are concerned with the problem of economic growth, we should, I think, give the reduction of the corporate income tax high priority. Savings out of corporate tax reductions are high (consumption out of these tax reductions is relatively small) and a lowering of corporate tax rates increases at the same time the willingness to undertake risky investments.

Such a long-run plan would involve raising Federal nondefense expenditures (other than the sum of interest, veterans' benefits and agricultural subsidies) at about the average rate in which output rises, say, as a yearly rate of 3 percent to 4 percent. In other words, these nondefense expenditures would on the average be increasing by several hundred millions a year, perhaps by close to one-half billion, at present prices. Some of this increase could express itself in rising grants in aid to State and local governments. We cannot get steady growth without an adequate amount of that kind of public spending which is complementary with private investment. Along the long-run path of the economy, room must be made for the public-expenditure requirements of a growing economy as well as for tax reductions.

It must be admitted, of course, that the proportions in which a potential surplus is to be divided between gradual tax reduction, gradually increasing government expenditure, and actual budgetary surplus, cannot be decided on objective or scientific grounds alone. Value judgments enter here. But grossly unreasonable decisions in these matters are nevertheless objectively wrong, in that they can reduce the actual putput considerably below the potential output.

I shall now turn to the question of whether we should start along these lines of gradual tax reduction as soon as the budgetary surplus tends to grow beyond very modest levels. Or should we conclude that the present period calls for additional anti-inflationary monetary and fiscal measures, including a higher budgetary surplus?

To me it seems that in our attempt to stem the inflationary trend we should give thought to methods that require no more general monetary-fiscal restriction than we have now, and possibly to methods that require less than the present degree of general monetary-fiscal restriction. In the event that in the fiscal year 1958 the surplus in the administrative budget tends to rise beyond $1 to $2 billion, then, in my opinion, much can be said for a small tax reduction. This is true especially if our policy agencies are willing to explore other methods of reducing the inflationary trend.

My reasons for suggesting this course of action are the following. Since 1955 our growth rates have been small. The recent uptrend in prices presumably results from a wage push rather than from demand inflation. While this certainly does not speak for going easy on the demand side, the character of this inflationary trend makes it difficult to get the situation under control by methods the impact of which is concentrated entirely on demand. Moreover, it would be desirable to exert the necessary demand-restraining influence in part by measures that restrain specifically consumption expenditure rather than investment.

I would like to suggest, therefore, that thought should be given to the following combination of policies. If at unchanging tax rates the surplus in the administrative budget should tend to rise beyond a very moderate level, and if it should be possible to achieve this without impairing the Government programs required for national security and for healthy domestic growth, then we should consider reducing first those taxes which bear on new capital formation.

We need more capital formation and more growth than we have had recently. If moderate tax reductions of the investment-stimulating variety should turn out to increase the rate of wage-cost inflation to a noticeable extent, we should consider reintroducing selective credit controls to curb the expansion of consumer credit. It would be desirable to exert a smaller restraining influence on investment and, if necessary, a greater and more selective restraining influence on consumption. General credit restraints could, of course, also be used to offset the consequences of a potential miscalculation in the timing of gradual tax reductions, although if it should turn out that the effect of corporate tax reductions must be offset by further general credit restraints, then at the end little could be said for this combination of policies.

Yet it may prove unnecessary to restrain consumption specifically, or further to restrain credit in general, when investment is stimulated by tax policy. Success or failure of the effort to curb wage-cost inflation may not depend on whether, when the occasion arises, we let the budgetary surplus rise by further 2 or 3 billion dollars or whether in such an event we keep the budgetary surplus low by reducing taxes on new investment. Indeed, more investment raises the rate of increase in labor productivity, and to this extent it might reduce the gap between money-wage trends and trends in the productivity of labor. It remains to be seen whether this weighs more heavily or less heavily than the stimulation of demand, so far as the effects of tax policy on wage-cost inflation are concerned.

Let me end by expressing the opinion that the situation which our growing economy faces calls for deliberate long-run planning of gradual tax reductions on the one hand and of gradual increases in growth-oriented public expenditures on the other. The situation does not call for haphazard and risky cuts in the budget. There is little difference between starting to put into effect a long-run plan this year and starting to do so next year.

Representative MILLS. Our next panelist is Mr. John K. Langum, president, Business Economics, Inc., Chicago, Ill.

Mr. Langum, we are pleased to have you with us this morning, and you are recognized.

STATEMENT OF JOHN K. LANGUM, PRESIDENT, BUSINESS ECONOMICS, INC., CHICAGO, ILL.

Mr. LANGUM. Mr. Chairman, I have a brief prepared statement on our subject, Fiscal Action To Promote Stability and Growth.

Inflation remains a very real problem before the Nation. In spite of soft spots in many parts of the economy, aggregate dollar measures of activity are at record levels. Severe pressures continue in the money and capital markets, with demands for funds outrunning the supplies of funds made available through current savings. Many prices and costs are still moving up, with more increases still to come in the months immediately ahead. Overall, the American economy is still operating under pressure.

The adverse effects of inflation include more than the current adjustments necessitated by higher prices and costs. Beyond that, there is the vicious cumulative impact of inflation. Not least of the difficulties here is the growing belief by the public, by business leadership, and by investment managers that continued inflation, at least in a gradual degree, is a certainty. These views, increasingly translated into action, could bring much more inflation. Further, a speculative bubble on top of the investment boom would certainly be followed by a downturn in business of a degree which we should not have and need not have.

In these circumstances, the objectives of stability and growth both point to fiscal action—and monetary policy as well—designed to restrain somewhat the spiraling of demands on the economy.

In the fiscal field this calls for strong efforts to restrain Federal expenditures, with due regard to priorities of national defense and social welfare. In the light of the prospective state of the Federal budget, general tax cuts at this time are not economically desirable. Furthermore, maintenance of a cash surplus in the Federal budget is particularly needed at this time to support Treasury public-debt operations and beyond that to back up indirectly current Federal Reserve policies.

Until the investment boom and inflationary pressures clearly end there should be no general easing of tax policy and credit restraints, in my judgment. The good short-run outlook for business and the immediate problem of inflation, however, does not means that these will always be the economic conditions and prospects to which monetary and fiscal policies should give due consideration. Looking ahead a bit longer, it appears likely to me that the private sectors of the American economy may well face some continuing and stubborn problems in moving forward. The record and prospect of growth in the American economy is a proud one. But growth over the years has never meant and does not now mean growth in every year. A decline in business of the degree of severity implied by the word "depression," in my judgment, is simply not within the reasonable realm of possibilities in the modern American economy. But the business cycle is not yet dead. We certainly could sometime have a recession, a moderate decline in business activity. Even an economy moving sideways in real terms over some time is an economy of declining corporate profits and rising unemployment. Given the level of Federal expenditures, such a period of interruption in our growth trends, when and if it comes about, will be an appropriate time for decisive tax reduction.

The current concern over the Federal budget has served a useful purpose because it has focused attention again on the continuing challenge of control of the level of Federal expenditures. What this means simply is our national decision as to how we want to divide up the spending of our incomes, in broad terms, between the vital benefits of private expenditures and the very real benefits of most Government expenditures. No doubt this has been pointed up by recent developments in the economy.

Declines have occurred in profits of some corporations and serious difficulties in maintaining profit levels are common to most businesses. Per capita disposable personal income in constant prices has failed to advance during the last 12 months. The urgent priorities of national defense and essential public services underline the necessity for the most searching scrutiny and stringent control of other Federal expenditures, particularly where avoidable inefficiencies and market-supporting subsidies are involved. The Federal budget is big, but so is the United States. The problem is one of balance. In an expanding economy and in a troublesome world, how much of our real growth shall take the form of expenditures on national security, how much on essential public services, and how much on private investment and consumption.

Representative MILLS. Thank you.

Our next witness is Mr. William C. Flaherty, director of business research for the Chrysler Corp.

Mr. Flaherty, we are pleased to have you with us this morning, and you are recognized.

STATEMENT OF WILLIAM C. FLAHERTY, DIRECTOR OF BUSINESS RESEARCH, THE CHRYSLER CORP.

Mr. FLAHERTY. Thank you, Mr. Chairman.

The memorandum on the economic situation and outlook, issued by the staff of the Joint Economic Committee May 23, 1957, presents a picture of moderate optimism for the next year. No marked change is anticipated. A continuing slow increase in economic activity, as measured in dollar terms, is anticipated, with some of the gain reflecting price changes.

Consumers are enjoying record incomes and spending selectively at high levels. They appear to be saving at about a $21 billion annual rate, and thus are improving their debt and liquid-asset position.

Business continues to make record plans for investment in plant and equipment, with outlays for 1957 estimated to run about 12 percent above the 1956 level, and with 1958 totals expected practically to match those of this year.

Purchases of goods and services by government are rising on all levels, Federal, State, and local.

Evidence continues to confront the economy that inflationary pressures are strong. Tightness still exists in the money market. The outlook for prices is for further increases over the next several months.

The members of this panel have been asked, in the light of this economic outlook, to discuss what types of fiscal action would be conducive to stability and growth, were reductions in Federal Government expenditures in 1958 to be realized, and to indicate whether fiscal tax action should emphasize investment or consumption.

GROWTH

The Nation continues to experience an almost explosive population growth. By 1965 it is estimated there will be approximately 195 million men, women, and children in the United States. Fastest growing in our population is the school-age group 5–24 years of age. In 1945 they constituted 25 percent of the total. In 1965 it is estimated they will account for 37 percent of all persons in our economy. The economy is just beginning to sense the magnitude of the demands for goods and services that this growth pattern will represent. Our labor force will increase more slowly than total population until late in the 1960's. There will be an actual reduction in the number of adults between 25 and 44 years of age between now and 1965. In this period the increase in the adult population of working age will be only in the age group 45–64 years.

The economy has experienced a rate of growth of approximately 3.6 percent per year in physical output terms since World War II, as compared with a longer term growth of about 3 percent. To achieve higher standards of living for more people by 1965, despite the relatively smaller labor force there will be available, demands a markedly higher productivity of goods and services. The goals of higher material well-being for more persons, the growth of personal satisfactions in work, in leisure, and in general living cannot be achieved without sharply increasing productivity. This in turn demands a continued high level of capital investment in new plant and equipment. An economic growth rate that merely parallels the rate recorded during the last 10 years could very well fail to bring about the realization of essential major economic goals.

INVESTMENT

Investment is the key to long-term growth. Plant and equipment expenditures are probably a more important determinant of the course of economic activity than an equivalent amount of any other type of expenditure that might be made by the private sector of the economy. While investment decisions are primarily the responsibility of business, the subject matter before this morning's panel recognizes the responsible role that government can play with respect to business investment and economic growth.

In increasing measure the investment decisions of business are reflecting the results of scientific research and development programs. Intense competitive pressures are emphasizing for business today the importance of process and product innovations. Research undertaken to determine the future needs of a growing economy and the investment opportunities there afforded, thus also becomes a powerful competitive tool for modern management. Moreover in an economy where free choice of consumers determines what products and services will be purchased, survival of the individual firm depends on its ability correctly to appraise through research and fully to satisfy through production the demands of its prospective markets.

Parenthetically it might be noted that research and development programs have a broader implication than that relating to the domestic business cycle. It is the technological know-how of the Nation operating within our political and economic framework that promises to keep us ahead of other nations possessing perhaps greater manpower and with different political and economic philosophies.

Organized research is estimated to account this year for expenditures of $7 billions. By 1960 its annual outlay is expected to reach $10 billions.

Because of such programs and outlays, much larger shares of capital investment are going to provide new and improved processes and new and better products. Through research and development the diversification of our industries has also been increased. Because of research and development, and business planning for long-term goals, a continuing stream of investment expenditures tends to become a stabilizing force in the economy.

Incidentally a high proportion of business-investment dollars has been going merely for the replacement of wornout facilities. During the period 1950–55, slightly more than one-half (53 percent) went for replacement and modernization, and the remainder (47 percent) was devoted to expansion. In 1955, of a total of $28 billions in investment expenditures approximately $13 billion (45 percent) were used simply to replace wornout equipment.

Since preparing these notes my attention has been called to some information estimated for 1958 which would indicate that for expansion the amount was somewhat over 50 percent, some 54, or 55, as I recall. The demands of the economy over the next decade indicate the need of higher levels of investment in new productive facilities.

In summary, the economy will demand a greater rate of growth over the next several years than it has to date experienced. In a competitive economy research, development, invention, innovation are the activities that must contribute to this growth. As the generative forces behind economic progress, they must be the source of new industries, new products, new jobs, higher wages and income, and new and better ways of living.

CONSUMPTION

It is evident that a sustained high level of capital investment depends upon high levels of consumer expenditures. Consumption, however, unlike investment, cannot of itself directly result in growth. Consumption confirms the correctness of investment decisions, and in turn sets the stage for continued invesment.

Business recognizes no fundamental opposition between investment and consumption. For example, distribution and marketing problems of a firm become easier to solve, the more bouyant consumption is.

CONCLUSION

Relative emphasis in fiscal tax policy on investment rather than on consumption, or vice versa, should in the short term, be framed in the light of the current economic situation. Thus, in terms of the present outlook for 1958, as expressed in earlier panels before this subcommittee, and elsewhere, should a substantial budgetary surplus develop in fiscal 1958, it would seem appropriate for fiscal tax policy to emphasize investment, for the reasons that consumption expenditures are expected to remain strong, and there is considerable evidence of barriers to planned investment. Under different conditions, the emphasis in fiscal tax policy might appropriately be directed toward consumers.

For the long term, while fiscal action must be conducive to high levels of both investment and consumption, it must be recognized that within the framework of our economy the mainspring of economic progress and growth is investment.

Representative MILLS. Thank you, Mr. Flaherty.

Our next panelist is Prof. Paul A. Samuelson, department of economics, Massachusetts Institute of Technology.

Professor Samuelson, we are pleased to have you with us and you are recognized.

STATEMENT OF PAUL A. SAMUELSON, DEPARTMENT OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Mills, I do not have a prepared statement, but I am participating in this academic seminar as an economist critic and I think I first ought to make certain disclaimers for my profession.

Economics is not a science and the economist is not like a medical doctor who tells the patient what to do. I would say the much better analogy is that the economist is like a skillful lawyer who asks his client, "What is it that you want to accomplish?" And then he tries to outline the most prudent way of achieving that objective.

I emphasize this because as I scrutinize existing economic trends I see a great deal of freedom of action to the Ameriacn people and to the Congress. There are no necessities that I discern from the side of economic law saying that the budget should be greatly cut now or that we cannot afford a greatly expanded defense program.

On the contrary, at the moment the situation is extremely flexible and it is really up to the American people what they want.

Let me illustrate my meaning. We have been in a lull. I don't think that we can feel too complacent as we look back on the last year. For the better part of the year we have had one of these sideways movements that Mr. Langum talked about. We don't insist that an economy break records in every year, but the fact of the matter is that in a progressive economy it is a very poor year in which you don't break a record: I think that is par for the course and should be taken into account.

In addition, productivity from the various statistics that I have seen does not seem to me to have behaved too well in the last year. It seemed to perform very well as we came out of the mild 1953–54 recession, but within the last year productivity hasn't shown much ebuliency. I ask myself why, considering the tremendous amount of capital development we have had, with the great emphasis on automation, this has been the case. I suspect—and I should admit that productivity figures are not very accurate—that probably the explanation is to be found in the lull itself.

Product mix is very important and when there is a relaxation of general demand in the economy, such as we have been witnessing for the last couple of quarters, there tends to be a downgrading of the job mix. When there is a strong expansion, as took place after 1954, people tend to move into higher productivity jobs. Their productivity doesn't change as a person, but they get into a more effective position. So I think that I want to suggest for your consideration an element that not very many winesses before you have stressed, namely, that an overpreoccupation with inflation is not always a prudent course for the Nation's household and we may be running certain risks with respect to the very rate of growth that we are all interested in.

Mr. Langum spoke of the existing inflationary threats. I would suppose that if we manage our economy well that for the rest of my life inflation will always be just around the corner. It is only if we manage our affairs badly that inflation will be banished as a threat. However, let's look at the existing situation. I am prepared to admit with Mr. Langum that if ever the American public decided that we were on a gravy train of inflation there would be all kinds of snowballing effects. I don't discern those in the present scene.

The cost of living, it is true, has been rising. I would argue that an economist who tried to analyze this in terms of demand, the balance of demand forces in the last year, will not have an easy time explaining the price rises. Which items in the cost of living have been rising? Are they items that reflect speculative pressures? Are they items that my wife can notice are occurring and rush out and anticipate with forward buying?

I suggest that the evidence is to the contrary. Purchasing agents, for example, in business who are very alert to these trends in fact have been behaving in a very restrained manner. That is why we have been having the inventory relaxation that was recorded so dramatically in the first-quarter figures. I see no stampede on the part either of business or the consumer to rush to buy forward because of a belief in the inevitability of the inflation. On the contrary, in wholesale prices, in staple prices, in the prices on organized exchanges, there is not a price increase at the present, nor, looking at the pattern of futures prices, does it appear to be imminent. What we do have is an increase in the prices of regulated items. My wife cannot anticipate our purchase of electricity and yet our electrical bill is going up all the time. It is these regulated items which are catching up that are primarily apparently responsible for the cost-of-living index wild rise. Service items generally, doctors' services very noticeably, have been going up. Things that involve heavy wage content have been going up, and I am afraid that is the trend to be expected under modern capitalism. Where you have a pure service with no technological change, unless the provider of that service is not to share in our progress, those items must go up.

So I would conclude that I do not see a strong, imminent, present danger of inflation attributable to the balance of demand factors.

This does not mean that I am pessimistic about the general business outlook. As a matter of fact, nobody can predict with confidence, in so mixed a situation as the present, the outlook; but I would venture the guess that the second half of the year may show a resumption of expansion.

I wouldn't expect that the modest inventory decumulation, modest it is true, but nevertheless inventory decumulation, that was recorded in the first quarter of this year would be the precursor of a recession like the 1937–38 recession, or the 1948–49 recession, or even perhaps like the middle 1953–54 recession. Nevertheless, I simply want to bring to your attention the possibility that some risks on the expansion-area side may actually pay off in terms of the goals of progress itself.

There has been a good deal of testimony before you and I agree with a good deal of it, but I want to redress the balance that seems to have been all in favor of investment and against consumption expansion. I think we must remember that the goal of all our economic activity is consumption, not investment. Investment is very important, but it is because it will later give rise to higher consumption. We should always keep this goal in front of us and not lose it. Otherwise, we become a little bit like the Midas fable, a nation that is always planting, always reaping, but never consuming, always plowing back in a tremendous Ponzi expansion.

I will illustrate this by a story about an Oxford don in the First World War. He was asked "What are you doing to save civilization?" He said, a little antisocially, "I am the civilization they are fighting for."

I don't think we want to forget that the whole purpose of all this is to have a higher standard of living.

I would also argue that if we have better educated children, and increased consumption standards at the lower-income levels, this too is an important factor directly relevant to the rate of progress. Prof. Theodore Schultz has been making a very thorough study of the development of Latin America and I was astonished to find that this quite conservative economist has concluded that mere capital formation in Latin America is only one element in explaining those countries that have gone forward very quickly. He would give very great weight to many of the items that we as economists would throw in the consumption sphere as being the important determinant of the decade-to-decade rapid rates of expansion which some of the more fortunate of those countries have shown.

I would summarize then this opening statement by saying that as far as the economist know-how is concerned, the problem is pretty widely open to you people. I speak of you people as the representatives of what the American people want. The economist can spell out what would be the risks in doing some of the things you want in certain ways, what would be the advantages in doing them in other ways, but he cannot from his expert knowledge of statistics and his study of the principles of economics presume to give you any narrow dictates of policy.

Representative MILLS. Does that conclude your statement?

Mr. SAMUELSON. Yes, sir, except for some additional material which I am supplying for the record.

(The material referred to follows:)

(This was prepared at the request of the editors of the Financial Times (London), May 3, 1957.)

THE MID-1957 AMERICAN ECONOMY

Recent American business behavior has turned up some puzzling problems for the economist. For 6 months we have had what I shall call the pause. Is this the pause that refreshes and presages renewed expansion? Or is it the pause at the top of the short-term business cycle, to be followed by a familiar pattern of recession?

I. To help answer these questions, let's review a few facts.

1. Production, as measured by the seasonally corrected 1948-based Federal Reserve Board Index, has held at 146 in every month from October to March—except in December when it rose to 147.

2. The new gross national product figures for the first quarter of 1957 show the smallest quarterly increase since late 1954. At $427 billion GNP has been climbing at a rate of less than 3 percent per year. This is probably below the rate of price increase; so real GNP has recently been standing still.

3. Consumer prices continue to rise at a rate of almost 4 percent per year. However, wholesale prices have been leveling off as drops in copper, zinc, and other staples have been offsetting the rise in industrial prices.

4. Auto production and sales for the first third of the year turned out to be little better than last year's disappointing rate. The invincible General Motors has been losing Chevrolet and Buick sales to Ford and Chrysler, who have had really new 1957 models to sell. Will the really new 1958 Chevrolet win back buyers at the expense of the "merely face-lifted" 1958 Fords?

5. Residential housing starts are currently not only below the much-talked-about 1 million mark, but are even running below 900,000 per year. Yet total dollars spent on all construction is still at historically high record levels. Deflated, though, for price increases since last year, real construction spending

must be down slightly. Yet March's construction awards show an uptrend, primarily in public and nonresidential projects.

6. Net foreign investment has been rising steadily for six quarters now. Our domestic purchasing power is being raised by this factor twice as much as it is being lowered by our budget surplus. American economists pay little attention to foreign trade statistics: I have been to Washington conferences on the business outlook where international trade was never even mentioned. But can our exports rise by 25 percent each year with imports remaining constant—as was the case between early 1956 and early 1957?

7. Business expenditure on plant and equipment is high. It rose less rapidly than firms said it would in their answers to the Securities Exchange Commission-Department of Commerce questionnaires. Firms say it will average 6 percent higher in 1957 than in 1956. Indeed, the new McGraw-Hill survey looks for a 12 percent increase in 1957.

8. Unemployment has been redefined this year so as to look higher than last year. But the new figures show a slight downward trend; and corrected for changes in definition, unemployment may be lower than a year ago. However, the hours worked per week have been slightly declining.

9. We have inadequate measures of productivity. But they do suggest that productivity has not this last year been growing at its usual rate: certainly its growth rate was much less than in the previous year of upswing from the 1953 to 1954 recession. Why this lagging pace? Where have the millions of dollars spent on automation gone? What of the view that holding down inflationary gaps improves worker performance?

II. I could go on to enumerate other important facts about our economy. A pattern of conflicting cross-currents would certainly emerge, with no clear trend up or down.

But let me point out some interesting surprises in the 1957 data. If you follow regularly the Nation's economic statistics, you find yourself quite prepared for the new statistics as they become available. Rare is a major surprise—and all the more enjoyable when it does occur.

I must confess that I expected some decline in the rate of inventory accumulation. With metal prices sagging, with inventories having been growing fairly steadily ever since autumn 1954, and with total production leveling off, I was prepared to find some drop from the 1956 fourth quarter +$4,100 million annual rate of inventory accumulation.

But the new figures for 1957's first quarter show zero inventory accumulation, and actually some slight decumulation for nonfarm businesses. To be sure, these figures partially correct for rising prices; nonetheless this is a significant drop. Often in our history such a drop has come in the train of an overall recession.

What to make of this? First, one might wonder whether the Department of Commerce will not later revise its figures upward. (The first figures are almost "forecasts": remember even the revised figures are "backcasts.") Still it would be arrogant to explain away one's surprise by such a supposition.

Second, one wonders whether the reduced inventory accumulation presages more of the same and even some decumulation? Or whether it is a plus factor, implying inventory rebuilding in the future? Pure reason cannot decide the question. One investment analyst tells me he thinks the process is but half over. Sumner Slichter, a man worth listening to on American developments, differs: he seems to think the lull in inventory building will soon make for greater inventory expansion. So far surveys of purchasing agents show they are still cautious on inventories. But if Slichter is right, they will gradually realize that steel prices and other prices will be higher after the middle of the year and will rush to reorder.

III. A less significant surprise in the new data relates to consumption spending. With auto sales disappointing, and with Easter 3 weeks later than last year, the failure of first-quarter retail sales to advance above 1956 seemed natural enough. So I mentally calculated that the ratio of personal saving to disposable income would probably remain at its recent level of 7½ percent, with no more than 92½ percent going for consumption.

The new official statistics show a decline in the savings ratio to just below 7 percent. Why has consumption spending increased more than income has increased? The answer seems to lie in neither the durable-goods sphere nor in the services sphere, but rather in the sphere of nondurable goods. And, yet, our textile industry remains in the doldrums, its usual peacetime state.

IV. To judge future prospects we must make guesses about future Government policy. What is the Federal Reserve likely to do? What changes is Congress likely to make in President Eisenhower's budget?

The Federal Reserve Board recognizes the pause. Consequently it has been doing nothing in particular—and doing it very well. In January most people in the New York money market seem to have thought that the corner toward easier money had been turned. At that time I expressed my reservations. And I'm glad I did; for, since then, Government bond prices have again weakened. Interest yields on municipal, corporate, and Government bonds are almost at their peak levels for a quarter of a century.

Mortgage money is perhaps a little easier than at the end of last year. But, if this is so, it is probably more a reflection of the weakness of housing demand and of the anxious attempts of Government agencies to increase the availability of money to stem the housing declines, rather than any reflection of a definite turn toward overall easier money.

One suspects that the Federal Reserve observers are a little more fearful of a resumption of inflation than of a near-term recession. The adulation that many of us have given them for their rapid turn toward easy money at the outset of the 1953–54 recession grates harshly on their ears; for, in their heart of hearts, they now regret their activism, and feel in retrospect that they then overdid the easing of money.

This makes me bet that similiar strong action is not in the cards, even if there should be some further weakening of business demand. While any serious deterioration would undoubtedly be met by vigorous monetary easings, the sticky situation could develop in which some continued price increase coincided in time with mild slackening in employment; and in that case I fear the Fed would keep a stiffer upper lip than I myself would advocate.

Should Slichter's strong last half of the year develop, a further tightening of the money screw can be confidentialy predicted. In every case the clue to Fed policy is easy to find: they will lean against the current wind; and stand up straight if they can't find a wind. Perhaps not too bad an epitaph for a central banker.

V. The more interesting policy question relates to the budget. As Secretary of the Treasury Humphrey leaves public life, his spur-of-the-moment sabotage of the Eisenhower budget continues to live on in memory and to reinforce what has become a strong congressional ground swell for a cut in Government expenditure. It is not that the Democrats and Republicans in Congress are against defense. Or against a thousand and one valuable Government projects. But they do hanker in the worst way for a cut in income-tax rates next year.

I am not a political prophet. So I shall simply report the growing belief that Congress may at least for the record cut a few billions from the Eisenhower recommendations for appropriations. This doesn't mean the fiscal year's spending will necessarily turn out a year from now to be much lower than his budget proposed, but it may permit Congress at the halfway point in the middle of the fiscal year to convince itself and the public that a tax cut has been justified.

If reductions in Government expenditure begin to be likely, or begin to seem likely to businessmen, there could be a repetition of the mid-1953 pattern in which inventory decumulation was touched off by the anticipation of defense cuts some time before those cuts actually materialized.

VI. Let me conclude by addressing my self to the question that most seriously concerns foreign observers of the United States. Is there any likelihood of a serious American downturn, comparable to 1929 or even to 1937?

The chances still appear to be against this. If peace broke out, if Eisenhower's health took a contemporaneous turn for the worse, an economist would be rash to deny that there might arise downward pressure on our business activity. But we would be very unlikely, I believe, to let the snowball into a serious and lasting slump. The Government has powers to prevent this and the political pressures would be likely to see that they are used. Here, I think, lies the difference between postwar and prewar America.

PAUL A. SAMUELSON.

NOTE ON INFLATION ANALYSIS

Along with other witnesses I have testified that the usual analysis of overall demand factors does not easily explain the following facts: (1) living costs were in recent quarters rising at a rate of some 3 percent per year; whereas (2) living costs had been nearly stable during the 5 years after early 1951, and with wholesale prices often falling.

I wish to confess that this failure of demand analysis cannot be regarded as well established, and will need much more study by economists. But suppose this diagnosis is correct. Does it follow—as I and other witnesses have said—that we must then invoke a wage-cost-push theory of recent inflation?

Not necessarily, must be my answer. Failure of one theory does not establish a second theory unless—as is rarely the case in economics—we can rule out any third theory.

But suppose we do think there is merit in the wage-cost-push hypothesis: Does that mean it is an alternative to the demand-pull theory? And that tax policy affecting demand will have no important effects on a wage-push inflation?

Again, I have to answer, "No." Some wage-push processes need excessive demand as a permissive condition, and will have their rates of inflation diminished or wiped out by strong contractionary fiscal and monetary policies. But still other wage-push processes are such that when you contract overall demand you will produce unemployment with little or no dampening effects on price increases. (If you repeatedly apply tight fiscal and monetary policies to such processes, you will slow down the economy's long-run rate of progress and will chronically lower its real prosperity level.)

Well, the lawmaker will ask of the expert economist, where does the United States of America stand in Mid-1957? Do we face cost-push or demand-pull? Or something between? Or something else again? If cost-push, will tight fiscal and monetary policy help—and with what costs to employment?

I wish I could pretend to give an exact answer. Or to state an answer that will with high probability be valid. But candor compels me to say that none of us economists can be sure we have identified the true causal processes currently operating.

I shall conclude this note by mentioning some of the technical difficulties in making the needed identifications. For brevity let W be the percentage change in average money wages per year, P the annual percentage change in average prices, and Q the annual rate of real productivity increase. Suppose prices and wages are rising with both W and P positive, but with real wages rising evenly in accord with productivity. Then if W equals P plus Q, which determines which? Of wage and price movements which is cause, which response? Which hen, which egg? If W is greater than P plus Q so real wages are outstripping productivity gains, is that necessarily a sign of wage-push as most of us have been saying? Not necessarily, Nor is P plus Q greater than W greater than O a sure sign of a demand-pull inflationary process: even if accompanied by money changes, this cannot surely be identified as demand-pull.[1]

If from these technicalities the tired legislator begins to suspect that economists' distinctions between different kinds of inflation are not yet very helpful, I should be the last to testify that his inference is necessarily wrong.

PAUL A. SAMUELSON.

Representative MILLS. Before we proceed this morning with questions by members of the subcommittee, it occurs to the Chair that possibly members of the panel might like an opportunity to comment on any of the statements made by other members of the panel.

Would you, Professor Heller, desire to comment on any statement made by any other member of the panel?

Mr. HELLER. Just one comment about Mr. Flaherty's very good statement. In particular, relating it to the problems of investment at the State-local level, we should keep in mind that it isn't just piling up capital on capital that gives us the economic growth; it is the increase in technology, and we are told time and again that the bottleneck these days is training and education. This is one of the key

---

[1] It would be wrong to infer from the fact that we see lightning before we hear thunder that lightning causes thunder. (Each are aspects of the same simultaneous process and the only correct inference is that light travels faster than sound.) Similarly, if we could discover that P jumps up before W—and in economic statistics such lag discoveries are rarely valid—we must still use caution in inferring causal direction: E. g., employers or speculators in organized markets might be anticipating subsequent wage-cost-push influences on supply of goods. (Fortunately, a good deal of policy is independent of these identifications. A good deal but, unfortunately, not all policy.)

problems that has to be solved. It accounts in part for my bias for more public consumption or, if you will, public investment in education and training which must take place at the State-local level and which underscores the necessity for some Federal action to underwrite this essential element of growth.

Representative MILLS. Professor Fellner, would you like to comment on any statement or observation of any other member of the panel?

Mr. FELLNER. Thank you, Mr. Chairman.

I think I would just say perhaps in one word that the kind of consumption which could be labeled just as well investment, that is to say, the kind of consumption that promotes growth, is, I think, more easily obtained by providing along the growth path of the economy for gradual balanced increase in absolute amounts, proportionate to the growth of output, of certain public expenditures, that is to say, I think that along that growth path there should be room for increased amounts, dollar amounts, of certain public expenditures, as Mr. Heller was pointing out, as well as for tax reductions. But I feel that if it is really growth we are interested in, then that is the way to get a balance between consumption and investment, and in our tax reduction policy I think we should keep the objective of stimulating private investment in mind.

Consumption obviously is the ultimate objective, but I don't think that we are likely to get more growth by reducing the taxes that stimulate private consumption, rather than reducing the taxes that stimulate private investment. In this context in which we are having this discussion at the present moment I think that we are likely to get the best growth rates, if we give high priority to the reduction of those taxes which bear on private investment, and at the same time make provisions for those public expenditures that stimulate the kind of consumption which alternatively could also be termed investment; namely, that increase future growth rates, such as education and similar expenditures.

Representative MILLS. Thank you.

Mr. Langum.

Mr. LANGUM. Yes; I would like to comment briefly on two points: one, the matter about inflation which Mr. Samuelson raised. I am concerned, as I think my prepared statement indicated, about the continued matter of sustained growth in the American economy, but I think one way we have to get at that matter of growth is to deal aggressively with short-run problems of instability.

As I see the American economy at this time, it is rather delicately poised or balanced between a possibility of a real set of problems relating to inflation, or actually going down somewhat into a moderate recession. There are problems on this matter of sustaining plant and equipment spending, on the matter on a lower level of activity in housing and automobiles, and the inventory adjustment. We might face serious problems in an economy moving sideways with the behavior of corporate profits. But at the same time I think there are 2 or 3 clear-cut instances in the economy right now where this matter of inflation is showing up. One, in business management decisions and in investment management decisions there is a markedly renewed emphasis, as I see it, on this question of inflation, on taking actions now to be set for this continued pressure of inflation over the years. In part, that is leading, I think, to a kind of accelerated emphasis now on plant and equipment spending and in part it could also lead to a rapid turnaround on inventory which, on top of other considerations, would present a problem of a speculative bubble on top of this overall investment boom. In the field of Federal expenditures, I believe that the influence of higher prices is pushing levels up. For that reason, while I am concerned about looking ahead a bit to a problem that could emerge on the down side at this time, I think inflation and particularly its implications for the broad field of fiscal and monetary policy is our basic immediate problem.

In the matter of investment, I agree very much with the emphasis which Mr. Flaherty placed on investment as a source of our growth and its importance in relation to growth. There are many and very profound factors that are pushing investment, that is, in the sense of business expenditures on plant and equipment, ahead and keeping it at high levels: The influence of technological progress, long-range plans of American business for growth over the years ahead, the much greater increase in total population than in the active labor force, and the pressure on every business in the country, no matter how large or how small, to try to put in more efficient equipment, offset higher wages and salaries, and hold down labor costs per unit of output. But I think we need to look at two other aspects of this matter of plant and equipment:

First, I believe there really is an important question of balance involved here, a balance in terms of our whole economy, between the emphasis we want to put on business spending on plant and equipment, and other types of expenditures, not only personal consumption, but Government expenditures, including the very important question of State and local expenditures. To merely say this program is good, this expenditure is desirable, isn't enough. It is a question of how desirable plant and equipment spending is, let us say, as against State and local expenditures, as against highway expenditures, as against residential construction, and so on. In the capital markets of the last year or two there has been a very real choice and balance between the demands of corporations to finance plant and equipment expenditures, on the one hand, and the impact of the overall monetary policies in part on State and local capital issues and housing finance.

The second thing, putting this point in another way, the American people are sometimes urged to save more so we can finance the higher plant and equipment expenditures, which we do need for growth, but that is a question of choice before the American people. Perhaps the American people would want more State and local expenditures on education or perhaps they want to make other choices rather than the saving for the higher plant and equipment. So I think the matter of balance is an important one. Second, plant and equipment spending by business is important and crucial not only to growth, but to the question of economic instability, and we need to take care along with the emphasis on plant and equipment spending for growth that we don't pust ahead too fast for a while and accentuate a downturn in business which otherwise might be quite moderate.

Representative MILLS. Thank you, sir.

Mr. Flaherty.

Mr. FLAHERTY. Mr. Chairman, I should like to make a remark which perhaps in some sense repeats what is in the paper, but perhaps a little clarification of two terms might be helpful.

I did include a comment to the effect that business recognizes no fundamental opposition between consumption and investment.

I do note that Professor Samuelson, if I heard him correctly, did speak of the emphasis on investment and against consumption. I have been puzzled by the apparent occasional recognition of a conflict between investment and consumption, and I wonder whether perhaps the difficulty doesn't arise in this way: In speaking about aggregated or aggregate consumption, consumption of the economy as a whole, the total purchase of goods and services, I think it would be correct to say there cannot be any opposition between programs fostering investment and consumption for the reason that Professor Samuelson mentioned, that in the end the goal of economic activity is consumption.

If, however, one were to think of patterns of distribution of consumption, then conceivably one might see on the basis of value judgments a conflict between patterns of proposed investment and patterns of distribution for consumption. I was not speaking of consumption in that sense at all.

One further point that I did not include in my paper and which I would like to touch very lightly because I haven't fully thought it through, deals with the demands on the American economy that are likely to be faced in the future with respect to what may be referred to as the free world. I would believe that in addition to providing an improved material and, to the extent it can, spiritual environment for the American people, the American economy will be called upon to play a substantially greater role on the world scene, and the demands for its know-how, for its products, for its processes, for its innovations, are very likely to increase rather than to diminish.

In conclusion, my paper is really directed to the point that taking growth in the broad sense, as I have attempted to identify it here, as a very important target or goal for this question, it would be dangerous were one to look at the rates of growth in the past and feel a sense of satisfaction or complacency from it, not that any one here is suggesting that, but that actually the growth rates of the economy need not involve piling capital upon capital in a wasteful or uneconomic sense, but actually can represent substantial improvement over the next 10, 15, 20 years, above anything which we have experienced to date.

Representative MILLS. Thank you.

Mr. Samuelson.

Mr. SAMUELSON. I have no comment.

Representative MILLS. Mr. Curtis.

Representative CURTIS. I have a basic line of thought I want to pursue, but before I do that I want to ask 1 or 2 collateral questions on 2 collateral matters.

Mr. Heller was talking about possible need for additional public investment in education, and yesterday the panel was discussing to some degree the question of the amount of Federal expenditures. I made no comment at that time, but I would like to raise a question about the expenditures in the field of education, let's say, or in the field of health, or retirement of our people.

From an economic standpoint it doesn't make too much difference whether it is the Federal Government, the State or local government, or private enterprise, or the combination that accentuates that, would you not say, or do you make a distinction economically now? It seems to me it is strangely a political question of where we place the emphasis on the additional expenditures. Take education as an illustration. I notice you used the words "public investment in education."

You really meant investment in education, did you not?

Mr. HELLER. Let me put it this way: I meant investment in education primarily, but secondarily I did mean public investment, because only through public investment can we achieve the optimal distribution of our educational expenditures. That is to say, if you want to get the biggest return on your investment in education you almost have to do the greatest share of it publicly. Only through public investment can the expenditures be distributed in a way so that all segments of the population and areas of the country can get the education they need regardless of their particular levels of income and ability to pay.

Representative CURTIS. I think then you have answered my question. In my judgment, at any rate, that is a political question more than economic. In other words, what you are emphasizing, as I see it, is the additional investment in the field of education, but you feel that such additional investment needs to be widespread, and how we might accomplish that, whether it would be done through Federal, State, local, private or what combination, and I think the same thing applies to all these other fields of expenditures with the only exception of defense, which of course is obviously an obligation of the Federal Government alone, although I might say that the Federal defense budget includes a large item for training and training in civilian type occupations, welding, radio repair, and so forth, so even there we get a lapover.

The second collateral matter I wanted to mention, and this too came up yesterday, but again it comes up today, in a reference to the recession of 1954 and the emphasis was just made here by Mr. Flaherty, too, is the effect—in fact, the whole panel has paid attention to the effect—that our international scene will have on our domestic economy. I constantly hear talk about the recession of 1954, but hardly ever does an economist in these panels refer to the fact that we switched from a hot war to a cold war, and it seems to me that that in itself is an underlying factor that effected the economics.

Must the mere shifting of several hundred thousands of men out of uniform with those men available for the work force where we had to get them jobs in the civilian economy had tremendous impact, and it does disturb me that we predict for the future the effect of international affairs on our domestic economy, and yet we don't study what has happened in the immediate past and bring out these factors, that to a certain degree, I imagine—I don't know to what degree it was—the shift from the hot war in Korea back to the cold war was bound to have had some economic effects domestically.

What I really wanted to get into, though, was this question of inflation. Mr. Samuelson has referred to an over-preoccupation with inflation. It is my judgment and my worry that there has been an underpreoccupation with inflation, particularly as we pay our attention to this particular subject, to promote stability and growth. Perhaps if we looked at the damage—that is my word—that inflation causes, we would perhaps be more concerned about what future inflation might bring about.

I have these figures computed for April on the cost of living index. It is 119.3, which again shows a further step up from March, which was 118.9, and of course we had an increase from 1955 to 1956 of from 114.5 to 116.2.

In other words, in just a period of 2½ years we have gone up from 114.5 to 118.9, which seems to be, to me at any rate, a very serious trend. I would like to just mention some things that I think the past inflation has done in our economy.

One, the people on pensions and retirement have obviously been deeply affected by the previous inflation. We get that in the Congress through the pressures to increase those security benefits, and indeed the minimum wage I would say to a large degree comes from that, increases of pensions of veterans and so forth.

Mr. Heller, the local governments, I would say to a large extent, particularly your local school districts, have been badly affected by inflation, because they essentially derive their revenues from real estate taxes, and real estate taxes of course depend upon real estate assessments and real estate assessments are put on the books over a period of decades, and of course they are put on with the dollar value at that time, and throughout the United States every county is troubled with this problem. Most of them have had to go in with a very difficult political problem as well as mechanical of reassessing all the property on their books.

The situation on business development, on replacement, I suggest to a large degree is the result of inflation, because it is not a question of growth as much as it is replacing worn out or obsolete equipment which was depreciated on our tax books with a certain dollar, the dollar that it was purchased with, and of course it only has half the amount in the depreciation accounts necessary to replace the amount, so an additional amount of investment is necessary for that.

I asked the panel yesterday and they said they didn't think that this inflation we are presently experiencing follows the traditional pattern. One gentleman suggested it was primarily the wage-price squeeze that has been referred to.

One of our panelists here, Mr. Langum, stated that, but it was a qualified statement with the word "probably" included in it, if I recall, if I am referring to the right statement. I would like to know what the panel feels is the real cause of our inflationary trends and whether or not the size of the Federal budget has anything to do with it.

Some attention has been paid to the tight money, the fact that there is a greater demand for investment capital available. How much does that bear on this thing, because unless we can maintain, as I see it, a stable dollar, a dollar that actually is a measuring stick of economic events, we are going to continue creating the same kind of damage that we created before that I have tried to suggest, unless we find out what the forces are that are producing this increase in costs, and I would like to have the panel, each one if they would, analyze for me as they can as to what they think lies behind this present price increase, inasmuch as most people seem to be agreed that it is not the traditional kind of inflation.

I would start right with Mr. Heller.

Mr. HELLER. Mr. Curtis, just one comment to begin with about this inflationary threat, namely, that while we have had approximately a year or so now of rising prices—you quoted the figures—we did prior to that have 5 consecutive years of remarkable price stability when the index didn't move more than 2 or 3 points. I think that was a very impressive demonstration of the fact that this economy can achieve full employment without inflation.

As to one of your collateral statements about the impact of inflation on State and local governments, may I note that, strange to say, it is in part the growth in productivity rather than inflation that is hitting State and local governments. So many State-local expenditures, notably on construction but also in education and other service functions, are in areas as Paul Samuelson pointed out, in which the wages have to go up because automation is pushing up productivity in other fields but which do not share, or share fully, in the rise in productivity. As yet at least, we don't, for example, have automation in our field of education.

Representative CURTIS. You did with the TV a little bit.

Mr. HELLER. Some of us in education may be displaced persons yet, but not at the present time. Consequently, economic growth and growth in productivity is somewhat paradoxically hitting the State and local governments very hard.

As to the nature of this current upward pressure on prices, there is of course a great deal of talk about the fact that it is a cost-push, wage-spiral inflation. There is much merit in that position. But I think it is also fair to say that only if the cost push is validated by a growth in final demand, in final monetary buying power, can it cause inflation. We have had constant growth in final consumer disposable income and spending, plus a big spurt in capital spending which tends to give the cost push an economic environment in which price rises can stick.

I don't think the Federal budget has been particularly a factor. We know the Federal budget has been dropping as a percentage of the gross national product. It has been dropping fairly steadily even when the dollar amounts of spending have been rising, so I certainly would not attribute recent inflationary pressure in any important degree to the growth in the Federal Government.

Representative CURTIS. Would you comment on the tight-money aspect?

In other words, the more greater demands for investment capital over the amount available, and of course that is reflected in increased cost of money, and I in my own view think that that is reflected even in common stocks because they get into competition, too. Do you think that has been a real factor in this inflation?

Mr. HELLER. Congressman, on that point I would say that the capital goods boom is definitely a factor in our inflation. The tremendous plant and equipment growth has tightened money. But when it comes to tight money policies per se, we have to distinguish between the higher cost of money and the impact on the prices of goods and services.

Representative CURTIS. I didn't mean policy. I meant the mere existence of tight money.

Mr. HELLER. Yes, the mere existence of tight money is the symptom rather than the cause of inflation. It is the symptom of the tremendous surge of demand for capital goods. Side by side with the sustained and steady growth of demand for consumer goods, this surge has created the tremendous overall tightness that we associate with some rise in the cost of money.

Representative CURTIS. In the long run, though, investment in capital goods would be deflationary; is that not true?

Mr. HELLER. In the sense that you increase capacity and thereby make possible the satisfaction of this growing consumer demand without rising prices, yes.

Representative CURTIS. Mr. Fellner.

Mr. FELLNER. Mr. Curtis, I believe that this is a very serious and very important problem, this problem of the inflationary trend. I think it is true that for several years we had stable prices, but only in the sense of a stable general price level or, more specifically, of stable consumer index. This was in turn a consequence of the fact that agricultural prices were declining at a rate at which they could not continue to decline and it was an important policy objective of the Nation not to have them decline any further. I think that the inflationary trend which now asserts itself was in a sense implicit even in the price tendencies of those years that preceded the past few years during which this inflationary trend became fully apparent.

Now I think we should be sufficiently honest to say that practically no empirically relevant proposition can be rigorously proved by economists in the sense in which a physicist can sometimes prove a proposition. Therefore, I would not go to the point of saying that we can prove that this is a wage-push inflation rather than a demand inflation by any really rigorous methods. I do believe, however, that the indications overwhelmingly point in the direction that this is a wage-push inflation rather than a demand inflation.

Just to mention three indications that I think sum this up, the only ones that are available, I do not believe that at present our sellers' markets are sufficiently tight sellers' markets to suggest that it is impossible to move along the way in which we have been moving without getting a 4 percent per annum increase in the cost of living.

Secondly, the developments up to about 1953, I would say, suggest that wages had perhaps a hard time keeping pace with productivity. Certainly the developments of the last few years point in the opposite direction, that productivity had a hard time keeping up with wages, and that that discrepancy is presumably somewhat greater than what could be attributed to dispersions around trends.

Thirdly, there are certain lag hypotheses which also point to this increase in prices having followed a wage push. None of this, as I say, is as conclusive as the propositions in the exact sciences. I do believe, however, that in other areas we usually have to be content with indications of this sort and then conclude from these indications that presumably the causation is going this way. It does not follow from this, of course, that we can afford to go easy on demand, because it is quite true that unless the demand situation is such that the wage push can become effective, it would not materialize, but, on the other hand, I think that the demand-restraining policies that would be required to eliminate this wage push might have to be very far-reaching demand-restraining policies, and this is the reason why I believe that other methods of coping with this danger should be explored. I think that perhaps something could be gained by systematic discussion of this matter in which the representatives of the various industries, and responsible labor leaders, and perhaps some economists, would participate.

I believe that the indications point overwhelmingly in the direction of wage-push inflation and that this is in the end in no one's interest. I don't know how we could cope with this problem exclusively by demand-restraining factors, but it is quite true that we should not go easy on demand as long as these pressures exist. Perhaps one way of trying to alleviate the situation is to try to get more satisfactory productivity trends, because what creates this inflationary picture is a discrepancy between the rate of increase in money wage rates and the rate of increase in productivity.

Perhaps to some small extent at least we could work on the productivity angle of it. We should try to work on the wage-trend angle of it too, although obviously everybody would like to keep away from administrative controls concerning wage rates. But what are the wage trends and what are the price trends that are compatible with the proper functioning of a market economy? This is a problem to which insufficient attention has been paid, I think.

Representative CURTIS. Thank you.

Mr. Samuelson.

Mr. SAMUELSON. I am against sin and I agree with you that inflation is something to be against, and any policy which without sacrificing other objectives could in any degree lower the rate of inflation, we would all be heartily in favor of.

I don't think there is any quarrel about that at all.

This, however, is a quantitative matter. You quoted some statistics that are very much in line with what Walter Heller mentioned. You gave a more than 2½-year period in which there was a 4-percent increase in the cost of living. I deplore every tenth of a point of that increase.

On the other hand, no economist in 1948, 1949, or 1950 would have bet that you could hold the inflationary rate down to that level. And if you take the history of capitalism, peacetime capitalism, I am afraid you face a history of progressive price increase. If we could hold things down to a very modest percentage per year, although I would deplore even having that, I think we would be doing very well indeed. And if this means that periodically Congress must change social-security rates, this is one of the advantages of the word "social" in social security as against private actuarial security. You can keep up with an inflationary situation.

The real problem is whether mild inflation must snowball necessarily, and I think that is what we should address ourselves to. That requires us to look at the composition of the price increase. I think that when in the past you had stable price levels, you had lots of prices going down to make up for those sectors like professors' and other professional services where there was less than the average rate of technological change. It is very difficult in the modern economy to make downward adjustments. We see it in the case of agriculture. Why do we deplore the end of the drop in agricultural prices when, as Arthur Burns pointed out just a year ago, when he was the adviser to the President, in his speech before the security analysts in Boston, that drop is a reflection of one of the greatest productivity changes in the economy? Today we like to make our adjustments on the "nondown" side.

I ask you what happens if nobody ever adjusts downward, a number of people make zero adjustments, and some people make upward adjustments? What kind of an average can you get from that operation?

It seems to me that you will get an upward bias. Professor Slichter has commented upon this. I don't think we have to regard this as an inevitable wave of the future, but I do agree with Mr. Fellner—and I was careful in the wording of my earlier remarks—that what was hard to explain about the cost of living increase in the last year was to explain it in terms of demand analysis of the conventional type. When we tried to construct our demand analysis inflationary gaps, they didn't point to a greater upward pressure in the last few quarters, when the cost of living was rising, than in earlier periods. So, in despair, we look toward the cost-push side.

These two aspects are interrelated. Obviously—I say obviously although no official admission has ever been made of this—the Federal Reserve in tightening money in the spring of last year had in mind the steel negotiations in the middle of the year. I think that this may have been proper for them, but it is a very dangerous business and you are fishing in very troubled waters when you attempt to use the overall fiscal and monetary policies of the Government to condition the environment within which collective bargaining and other bargains are made.

What is suggests to me is that life is going to be very interesting and tough for the policymaker in the years ahead. I myself have spoken of foreseeing the possibility of an increase in the last half of the year. I would attribute that in part, as Professor Slichter has done, to the built-in wage increases which we know are already in existing contracts, and which we think will be reflected in some degree in the steel prices in the middle of the year; and I have spoken of the restraint that purchasing agents and other men in business have been showing with respect to inventory and forward buying. Yet I wonder, when the price increase actually comes right in sight whether you may not get a little bit of a turnaround toward inventory accumulations. That was the reason underlying my feeling that the recent decumulation of inventory is not likely to snowball in the 1953–54 pattern.

Representative CURTIS. Thank you very much.

Mr. LANGUM. I also regard inflation as a very real problem before the Nation now, and I think it going to be a problem before us. Professor Samuelson made a comment earlier which I think we need to remember. I can't quote his exact words, but I believe it was to the point that if we manage our economy well and have a growing economy and an economy with relatively high utilization of our resources, we are going to keep on running into inflationary problems at different times and facing up to the question of how to deal with them. I think that the wage push has been important in the inflation and particularly in the last year, but it isn't just a matter of higher wages. If a business firm has higher wages or higher other costs and therefore pushes up prices, it doesn't stop there, because the demand has to be there to support that higher price and that volume of output, or the higher costs are going to result in unemployment and lower production. So I think we need to remember always that, as so often, there are several factors involved in this. Wage push is one thing, but I think the demand side is another thing. On the demand side I have two observations.

We just cannot put our finger on a sizable increase in Federal expenditures as a cause of the inflation, because in fact it hasn't happened. That is, going back to 1953 the gross national product in current dollars went up from $363 billion to $427 billion this first quarter of 1957, but during the same period total Government purchases of goods and services moved from $84.4 billion to $84.9 billion, hardly any change, with some drop in Federal purchases and some increase in State and local. So we can't point to a higher level of Government expenditures, I don't believe, as causing the inflation, given that comparison, except that the mere increase of course isn't a sufficient test.

As I see it, if the level of Federal expenditures or the level of any other kind of expenditures in the economy had been at a lower level during recent years, with everything else equal, we would have less inflationary pressures. But the Government spending has not been, it seems to me, the driving force pushing up prices, certainly in the sense of an increase in spending. Now, we have had a sizable increase in business expenditures on plant and equipment and at certain times in residential construction, and of course in the overall area of consumer expenditures.

I think that monetary policies have performed a very important role in restraining inflation as compared to what I think it would have otherwise. In 1955 and 1956 with tremendous demands for funds, a restrictive monetary policy in effect limited quite sharply the extent to which the commercial banking system could create new money and inject it into the spending streams in meeting these high demands for funds.

Now, the combination of high demands for funds relative to current supplies coming from savers and the monetary policies pursued brought about, together and in combination, the tight money. But I think we should look upon that more as a measurement of the underlying pressures and the monetary policies, in fact as something which served to lessen the inflationary matter rather than a cause of it.

Finally, we have to face up somewhere, I think, to the implications of a high level economy and this very difficult choice to some extent at least between inflation, even slow and gradual, and enough slack within the economy so that we will countenance some degree of unemployment.

I don't think we should set up as a goal for our economy operating always necessarily at capacity and under pressure, because if we do I think we run into enough added inflationary forces so that it adds up to a less desirable set of objectives.

Mr. Flaherty. Congressman Curtis, I have a comment on the point I think was implicit in some of the discussions on this particular topic.

I think it could be generally agreed that one cannot measure the effects of inflation statistically, and as a corollary of that the fact that we have achieved in our economy a relatively satisfactory rate of growth over the last several years in spite of a degree of inflation does not at all imply nor should it be construed as indicating that the inflation we have had has not been bad. The growth potential of the economy and the inner strengths of it may be sufficient to hide for a substantial period of time some of the effects in the aggregate of what would appear to be modest inflation.

Business, as most of us know, is very much concerned over the problem of capital erosion. To some extent that does reflect the impact of inflationary pressures. There is no available measure as to the extent to which investment decisions have been affected by inflationary considerations either one way or the other. Productivity has undoubtedly been affected by it, and there is some indication that it has been affeced adversely.

To the extent that inflationary pressures have been contributed to by the straining of demand against the capacity of the economy, so that in a sense inflation to some extent is due to our straining at the seams, then we can see the cost of that might be with us for a long time, modest as they might appear in any short period of time.

The indications I would think would call for increased attention to the mechanics of inflation and to attempts to measure more critically than has been to date possible the effects of inflation on various economic decision processes.

Representative CURTIS. Thank you.

Representative MILLS. On Monday I think there was a general consensus among the panelists that, though we may be in an interim period or moving sidewise, and the economy may not be as buoyant as it was in 1956, there is still enough zip left in our economy that we must be mindful of inflationary dangers in the establishment of fiscal policy.

It was pointed out by the panel on Tuesday, as had been previously pointed out by the staff of the Joint Economic Committee and by the staff of the Joint Committee on Inernal Revenue Taxation, that in spite of the cuts that have been made by the Congress in the 1958 budget and other cuts that may be in process of being made, actual Federal spending in fiscal year 1958 will exceed the January estimates made by the President in his budget message to the Congress. We may spend $72.8 billion or $73.5 billion, depending upon whether or not postal rate increases are provided by the Congress. In our study we are endeavoring to find out, in the light of present economic conditions and those conditions which we can foresee perhaps with some degree of reasonableness for the next several months, what the ingredients of sound, responsible fiscal policy are. It would appear on the basis of the testimony given to the subcommittee that if taxes are to be reduced substantially during the course of fiscal year 1958, we would either eliminate prospective surpluses or we would perhaps, if the tax reduction is substantial enough, create deficit financing.

The question in my mind is this: Whether or not there are problems relating to consumption and problems relating to investment that are of sufficient importance, as we view the present situation and as we look to the few months ahead of us for the fiscal year 1958, to justify providing tax reductions in one field or the other, even though we may create deficit financing or eliminate prospective surpluses for fiscal year 1958, and whether those considerations because of economic conditions should be given priority over the maintenane of a balanced budget and a surplus of a billion or 2 billion dollars if such is possible in fiscal year 1958. Would any of the members of the panel have any views that they would like to express with respect to this point of going ahead with a tax reduction in one field or the other, even though that action might lead to the results I have just described?

Professor Heller.

Mr. HELLER. Mr. Mills, as I indicated in my statement, I think it would not be responsible economic policy to proceed with a tax cut at the present time in the light of both the budgetary situation and the economic situation.

Representative MILLS. However, you recommend, Professor Heller, that we have something on the shelf or half shelf, which if put there would, of course, create greater political pressures, in my opinion, for its enactment, and with the people and the Congress hungry for tax reductions I wonder if in the act of putting something of that sort on the shelf we enhance the possibility of its enactment.

Mr. HELLER. Undoubtedly you enhance the possibility of its enactment, and that is why I stepped out of the role of economist to a somewhat different role in citing some evidence that the self-restraint the American people are capable of exercising in this field is perhaps greater than the current rush toward budget cutting seems to indicate.

There are some pretty encouraging signs of this self-restraint in terms of expressed voter preference for debt reduction over tax reduction, in terms of the politcal history of the Congresses that enacted tax cuts in the past 10 years, and in terms of the reelection of a President who had vetoed a couple of big tax cuts not long ago. If the American people are given the reasons for withholding the actual effectuation of these cuts, there is a fair chance that they would understand. Consequently, I would hope that the political danger, the political pressure implicit in working out a schedule of individual income-tax reductions and putting them on the shelf, would not be as great as it might appear on the surface.

Representative MILLS. The point is this: Can we describe ourselves as being responsible in the discharge of our duties in the establishment of fiscal policy if we do create deficit financing or the elimination of any surplus with respect to the fiscal year 1958 insofar as we can now gage economic conditions as they may exist during that period of time?

Perhaps I am antediluvian, but I can't understand the responsibility of action that would bring about deficit financing, except that there be some demands within our economy that are so overpowering as to justify priority over a balanced budget. If we are in this tight squeeze that we have had described to us my question is this:

Are there any problems with respect to consumption and investment that we know of today that should be given priority over the possibility of a balanced budget?

Mr. HELLER. Just so I am not misunderstood, I think I have already put myself clearly on the record for the fiscal year 1958 as saying no, there are no problems of consumption and investment that take priority over a balanced cash budget. At the same time I am concerned over the possibility of a slackening of the pace of growth and the fact that we ought to have action ready, willing, and able to go into effect promptly in that eventuality.

Representative MILLS. Why wouldn't you use monetary action first, Professor Heller, since we do have some considerable monetary restraints?

Wouldn't it be better to ease monetary restraint first, before creating the most inflexible situation of creating deficit financing?

Mr. HELLER. The product mix between monetary and fiscal policy is always important. I would use the two simultaneously if it were a fairly severe halt in our economic growth. If it were very mild, I would ease the monetary controls before moving into the area of tax reduction.

Representative MILLS. Professor Fellner, do you desire to comment on that?

Mr. FELLNER. Mr. Chairman, I also believe that if the budgetary surplus, the surplus in the administrative budget, is likely to come out somewhere in the neighborhood of 1 to 2 billions, then we should not consider reducing taxation in the present fiscal year. I do not believe that any one can really tell whether, if investment were somewhat stimulated by tax reductions, this would increase or decrease the rate of wages cost inflation event, but I think it is necessary to keep some rule of thumb in these matters because they just evade precise and nice calculations, and I believe it is a reasonable rule of thumb for the present fiscal year to say we hold on to the prospective surplus in the adminstrative budget which is small.

We are only slightly on the upper side of budgetary balance, so far as the administrative budget is concerned. Let's keep to this. I say this in spite of the fact that I am not really quite sure whether the inflationary situation would get worse or would improve, I think it wouldn't really change very materially, if a slight tax stimulus were given, additional stimulus to the rate of capital formation.

However, what I believe would be important is to have some sort of a long-run plan, a plan that tells us by how much we normally reduce tax rates as the economy is growing and by how much we normally increase our various nondefense expenditures as the economy is growing. These would be very small amounts indeed, of course, because the growth rate of the economy, while it can be impressive, is never so large as to make room for really substantial tax reductions and substantial increases in Government expenditures in any one year.

Representative MILLS. The type of tax reduction you are now discussing could not be described as a general tax reduction?

Mr. FELLNER. No, but if we think of a 5-year plan or a 10-year plan, then it would more or less affect all tax rates, simply due to the fact that not all Government expenditures should be raised, and I speak of absolute dollar amounts. Obviously there are some expenditures there that should be reduced if possible, that certainly should not be raised, and also because the tax revenue tends to rise at a somewhat higher rate then the output at given tax rates, so there is some room for tax reductions in very small steps, and there is of course the necessity to increase certain kinds of dollar expenditures as the population increases and as output increases, but again in very small steps.

I believe we should have such a plan, such a document, that somehow specifies what we consider to be normal. We should always be prepared to deviate from the normal if conditions call for it. The International situation may call for deviating from the normal and of course the business cycle may call for deviating from the normal, but what I would like to see is a situation where a specific decision must be made when we deviate from such long-run normals rather than create a situation where normalcy is doing nothing, and a specific explanation must be given when we are doing anything whatsoever.

I don't think that the static normal is the most desirable normal. I think we should have some plan that tells us how we proceed normally when the economy is growing normally and then should be prepared to deviate from this according as the situation develops one way or another. This would be my idea of what to have on the shelf, Mr. Chairman.

Representative MILLS. However, you would agree, I take it from what you say, that responsible fiscal policy requires the maintenance of a balanced budget at least in fiscal year 1958 insofar as you can foresee conditions that will exist in that fiscal year.

Mr. FELLNER. I would say that I would not now reduce taxes, yes.

Representative MILLS. Professor Samuelson.

Mr. SAMUELSON. I won't directly address myself to an answer to your question, but I would like to make a technical observation that may have some bearing on it, and I make this as a student of fiscal policy, as an economist, and not as an amateur politician. The political implications I think you will have to work out for yourself.

The question that I would like to examine is this: What is the effect upon the economy of a change in the budget deficit or surplus? Suppose that you have a budgetary surplus of plus $3 billion and you go from that to a budgetary surplus of plus $2 billion, or go to plus $4 billion. I have taken a $1 billion swing in every case. I want to compare the effect of that with going above or below budget balance. Budget balance let's define as zero, and let's discuss what happens if you are a half plus of surplus above that, or if you are in deficit with minus one-half billion below that. That is also a swing of $1 billion.

It may be—I suspect it is—a factor of tremendous political significance whether you go from a surplus budget to a deficit budget, but as a student of fiscal policy I must say that in the Federal Reserve Board index of production, in the plant and equipment expenditure intentions that McGraw-Hill and the SEC will pick up, these 1 billion swings are likely to be very similar events. I therefore like the remark that Walter Heller made earlier about constructive surpluses and constructive deficits.

It could well be that we would have a very strong upswing in the last half of this year due to a variety of reasons unassociated with Government that would automatically give you a surplus and a much more substantial surplus than anybody is now talking about. That should not to the student of economics be a cause for rubbing our hands and saying, "Aha! We will use this surplus to give out a tax cut." On the contrary, it will be the very overenthusiasm of business which will have created that surplus; and this will be a reason for more budgetary austerity rather than the reverse—because what we are looking for are constructive surpluses as against destructive surpluses, constructive deficits as against destructive deficits.

So except as a symbol to your political brethren and to the people, the question should, I think, not be asked exactly where should we stand with respect to dipping one dime into a deficit as against a surplus, but we should rather say, "Do we want many more dimes of surplus? Do we want to have more dimes of tax reduction relative to expenditure?"

You see what an amateur politician I must be in having the effrontery to have said that.

Representative MILLS. I think you would probably make a very good one. You were touching on one point of course that I had in mind that I didn't express, and that is this:

To what extent does responsible fiscal policy require an accumulation of surplus, for working cash in the Treasury, or for retirement of bank-held debts, say. Should we in fiscal year 1958 in the light of conditions that we reasonably foresee, strive for not only a balanced budget, but for a surplus of a billion, 2 billion, or 3 billion?

What should the figure be as an ingredient of sound, responsible fiscal policy for this fiscal year?

Mr. SAMUELSON. You are bringing me back to the original question and I would like now to answer with respect to one aspect of that. If there were some important structural tax reform that one thought ought to be made, perhaps ought to have been made a long time ago, I must say I look with some apprehension on the policy of waiting until the overall picture is right in order to make such a desirable structural reform. I will mention 3 structural tax changes, and I myself am not sure I have a position on any one of these 3. They will be quite different, but let's take, for example, the problem of the $600 exemption. If you will look at the cost of living during World War II when we were fighting for the salvation of the country and recall that we had a $500 exemption at that time, and if you will deflate the present $600 exemption for the increase in the cost of living since then, which is much greater than any of the sorts of things we have been talking about in connection with recent years, you might conclude that this is an extremely small exemption and that it is long overdue, that it be increased.

If you were of that persuasion, I would say to wait until fortuitously the overall situation is just exactly right so that you can have a tax reduction. It does involve the possibility of being left at the station for a very long time.

But lest it be thought that my point holds with respect to consumption taxes, let me take quite different examples. Suppose you thought that in the interest of a healthy competitive economy you wanted to lighten the burden on very small corporations. Now, everything involves revenue in this area. You can't be Santa Claus and do nice things for people without losing revenue. I would say that if this were a long overdue reform one should not necessarily put it off because of the overall picture. The same would hold for the case of faster depreciation that you thought desirable as a long-run reform.

Naturally, the overall picture is one of the elements in the push and pull on how you will act on all these.

Representative MILLS. What you are saying, Professor Samuelson, is this: That in your opinion the economic considerations, such as the possible threat of inflation and so on are not such as to deter Congress

93528—57——10

from taking action with respect to an increase in exemption or with respect to aid small business if the Congress is thoroughly convinced that there is need in those two areas for such action, even though such action might precipitate an imbalance?

Mr. SAMUELSON. Yes; particularly since all the figures we are talking about are for very small plus or minus items in relationship to the economy. Just remind ourselves that we are speaking of a GNP of $400 billion, and probably as we sit here, $431 billion—$427 billion was the last figure and this quarter's figure will probably show $431 billion. We are talking about a surplus of $1.8 billion plus. We are talking about zero. We are talking about a cash budget, an administrative budget of different small amounts. To be sure there are multiplied effects of these small amounts, but in the overall picture let's keep our sense of proportion. The future of inflation under capitalism is not going to be much affected by a half billion swing induced by long overdue structural reform. My only point is that this overall picture should not be a decisive consideration. It should naturally be given weight, but it should be given weight in terms of the quantitative magnitudes.

Representative MILLS. Let's analyze this a little further on your point. Assume that the Congress is persuaded to believe, as I am sure many Members presently believe, that there should be an increase in exemption from $600 to $700 January 1, 1958, which of course is midway through this fiscal year, and at the same time the problems of small business are such that the small-business people of the country should be given some relief from present taxes, that on the whole that would, say, amount to $1.5 billion for the remainder of the fiscal year and it might mean a $500 million deficit or a $200 million deficit or whatever it would be, that action alone, and we do that.

That then would force upon monetary policy the responsibility of taking some action, would it not, if inflationary pressures were not to become greater for the remainder of the fiscal year?

What would be the effect then of imposing such additional monetary restraints upon certain sectors of our economy.

I call your attention to the point that was made, as I read the President's economic message, in explanation of why more rigid monetary policy had not been exercised in 1956 to better control rises in prices. It was pointed out that to have exercised greater monetary control, or various controls, would have acted adversely upon certain sectors of our economy, and I assume those sectors would have been housing. I assume it might well have been small business. I assume it might well have been agriculture. Would we then, in order to make corrections that we think are necessary with respect to taxation, be imposing restraints through monetary policy upon sectors of our economy for whom we primarily intended these tax benefits which would be nullified as a result of the more rigorous monetary policy?

Mr. SAMUELSON. Without question there would be an incidence through other measures, upon the same groups whom you are helping with tax policy and you ought to take that into account in deciding whether to give a tax reduction to these groups. I would say, however, that if one was convinced that small corporations deserved, in the interest of competition or whatever reason, a lower tax rate, we would have a healthier economy to take this plunge and then let interest rates be determined in the free market and as conditioned by the Federal Reserve Board with its responsibility for overall stability.

We would have a healthier economy in the long run to do it that way.

Representative MILLS. I wonder whether or not we ever have a healthier economy, Professor Samuelson, where growth reflects and depends upon inflation rather than real increases in output with stable prices. I have always wondered in my own mind whether we are kidding ourselves when we allow for inflation as a permanent program in order to have economic growth. To me it isn't a real growth. If that is the result of the action that you would propose, I would certainly be very prone to question taking that step. If we can do the things you are talking about and then by adjustments of monetary policy without serious injury overcome those in the interest of avoiding further inflation, then I think it might be well for us to consider this suggestion that you made.

Mr. SAMUELSON. I want to be very objective here and not have any ax to grind. I should like to point out that one of the pressures which you must take into account in such action is not simply the pressure upon the Federal Reserve Board, but the pressure that will be upon you as Congressmen once you have a destructive deficit to raise taxes in some other direction. If structural reform is truly deemed to be needed, then the resulting pressures in other directions, including pressures upon yourselves, perhaps ought to be faced.

Representative MILLS. Thank you, Professor Samuelson.

Mr. Langum.

Mr. LANGUM. Mr. Chairman, my answer to your question is "No," looking ahead now at fiscal 1958. I see no special consideration in the fields of investment or consumption which should be given priority over the maintenance of a balanced budget and some surplus. In fact, stability of the economy and growth of the economy means looking at investment and consumption. I think we need to concern ourselves with the level of expenditures as well as with the question of a surplus or a deficit. As I see it, a suplus or deficit is of particular consequence because of its impact upon private expenditures. If we have a surplus and use it to retire bank-held Federal debts we are taking money from the private sectors of the economy, destroying it, and certainly limiting private expenditures.

Representative MILLS. It is depressing.

Mr. LANGUM. Yes, sir. However, there is also the question of the sheer level of demand from Government expenditure as one component of demands in the economy. It isn't alone a matter of a surplus or deficit.

Finally, I was very much intrigued by Walter Heller's suggestion about a tax cut on the shelf. There are some things about it with which I agree very much, particularly with the acceptance of the idea that if a major cessation in growth or recession comes about, we are prepared and willing to use a tax cut in addition to other Government policies to combat that cessation in growth or that recession.

I think it is important that we accept that idea because if there are enough fears of a deficit at that time, then a deficit in that setting could have the effect of frightening particular businessmen, let's say, and others and causing some downward aspects as well as the stimulation to demand which should otherwise result from a deficit at that time.

On the other hand, I am disturbed about the political pressures for tax reduction that would be involved also with a tax cut on the shelf. We do have enough built-in flexibility it seems to me with our structure of Federal revenues so that if business shades off that built-in flexibility, particularly on the revenue side, and the very quick flexibility in monetary policy, will serve as the first steps at least in combating a recession or cessation of growth if and when it appears.

Representative MILLS. Thank you.

Mr. Flaherty?

Mr. FLAHERTY. Briefly, Mr. Chairman, my answer to your question, first based upon the assumptions that the budgetary surplus would be modest and in proportions of no more than 1 to 2 billion dollars, on the assumption further of continuance of the economic activity generally in the pattern described in the memorandum of your staff, would be "No." I would say specifically on that point that the important element would be the actual development of economic activity as the year unfolds, and that at first, were weaknesses to hint at its coming, considerations should be given to modifications of monetary policy in the hope that they might be able to prevent a more serious downturn. Were the downturn to develop in more substantial fashion, then it would be a matter of determination of the type of tax action to be taken.

Representative MILLS. Thank you, sir.

Mr. Heller, I didn't want you in your principal statement to overlook one matter I think maybe you did overlook. You said that over the years we had given preference to industry in some manner or other, as you described, in Federal tax laws, and you were suggesting that we give some preference to State and local governments to better enable them to discharge their responsibility.

We already have a preference, do we not, for the benefit of State and local governments in the tax exemption of the interest on the bonds that they issue? That is already a preference, is it not?

Mr. HELLER. Yes, this is an important preference. At the same time, because of the tremendous growth in State and local bonds outstanding from $16 billion to over $50 billion in the last 10 years, there has been a tendency toward saturation of the upper income groups who can benefit most from this exemption. Consequently, there has been this double pressure on the coupon rates of municipals, and they have been rising faster than the average coupon rates in the economy.

Representative MILLS. If we add further preferences to the law do we not then create greater problems of equity in the Federal tax structure?

Mr. HELLER. I wasn't really thinking of specific preferential tax treatment in the sense of further exemption. I was thinking more in terms of these directional tax cuts.

Representative MILLS. The elimination of certain taxes that might better be utilized by State and local governments. That was your point?

Mr. HELLER. That is my point.

Representative MILLS. I wanted to be straight on that in the record.

We have a quorum call at the present time in the House. Do you want to ask some more questions?

Representative CURTIS. I have 1 or 2, stimulated by Professor Samuelson's statement in regard to tax reductions and had to do with a point I wanted to raise.

I think there is a tendency to think of what I would term possible tax revision as tax cuts. There are many things in our tax structure that in my judgment call for revision and although it might look like there are tax cuts, that you might actually change the rate, the economic results it seems to me are not a net loss to the Government and particularly in this small business tax area.

Incidentally, it is not limited to small corporations, as I view it, because about 80 percent of small business is under the proprietorship of partnerships. It is very difficult to prove these things, but I do know that a lot of the mergers and acquisitions of the smaller businesses are resulting not from economics, as much as from the tax structure and a lot of the purchase price is being paid for in tax savings from the combination of big corporation A taking over the smaller B. I wish that more attention were devoted to that possibility.

I want to mention two specific situations which I wish economists would devote more attention to, to either prove or disprove my theory. I was opposed to the extension of the excess profits tax. The administration wanted to continue it because they said they couldn't afford to lose the revenue. I maintained that I thought if that tax, which was essentially on growth companies, were eliminated, the net revenue to the Government would increase through the increase in the corporate tax take. I can't prove that this was the cause, but it is certainly true that when the excess profits tax went off, within about a year and a half we were taking more from the regular corporate tax than we were getting from the combination of the corporate tax take and the excess profits tax.

One other item was on the stock dividend credit that was put in the 1954 Code. Contrary to the public impression, the purpose behind it—at least I was one of those who was strongly behind it—was to try to switch corporate investment from debt investment more over to the equity investment, and if we were successful in switching more debt investment into equity, and I am sure any one can see this as a theoretical formula, we would take more in the way of taxes from the investing public, not less even giving credit for the loss of the dividend credit.

I will say again there was a switch. Whether it was caused by these other factors, there was a big switch in corporate deinvestment into equity, and you can again figure on a theoretical formula that the Government got more revenue as a result of that switch through our tax on the investing public, even allowing for the amount that we lose in credit.

I did want comments on that, but I know we have to go. However, I did want to pose that because I have been very disturbed at the failure, as I see it, at any rate, of many people to look at the tax revision as a possibility that it is only a tax revision and not tax reduction. There are certain things that are really tax reductions. We will lose revenue.

Mr. SAMUELSON. Could I make a one-sentence remark?

Representative CURTIS. I would be very happy if you would.

Mr. SAMUELSON. I will go you one better and agree that it isn't only tax reduction that we are talking about. In years when there is needed a constructive deficit, in Heller's terms, but there is a long overdue structural tax reform which will increase revenues—and I can think of many loopholes in the present law which could be filled in—even though we need an overall deficit in such a year, that long overdue tax reform might well go in at that time and not wait upon a time when we need a constructive surplus.

Representative MILLS. We could be helped here if you could tell us how we could eliminate those loopholes.

We thank you so much for your appearance this morning and your very helpful testimony before the subcommittee.

The subcommittee stands adjourned until 10 o'clock in the morning, to meet in room 224 of the Senate Office Building. I understand that is the Interior Committee room.

(Whereupon, at 12:18 p. m., the committee was recessed to reconvene at 10 a. m., Thursday, June 6, 1957.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

THURSDAY, JUNE 6, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to recess, in room 224, Senate Office Building, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Representatives Mills (chairman of the subcommittee) and Curtis; and Senators O'Mahoney and Goldwater.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy; John W. Lehman, acting executive director; and Hamilton D. Gewehr, research assistant.

Representative MILLS. The subcommittee will come to order. We are continuing with the subcommittee's hearings on fiscal policy implications of the economic outlook and budget developments. The purpose of these hearings is to bring into clear perspective the economic considerations which must go into responsible fiscal policy. Our discussion today will focus on the types of tax changes which would contribute to achieving the Employment Act objectives under present circumstances and under circumstances in which we could provide some substantial overall revenue reductions. We are concerned with the broad outlines of changes in our tax structure which would serve to improve the Federal tax system in terms of our economic growth and stability requirements rather than with detailed tax revisions.

We will hear the opening statement of each panelist before proceeding with the general discussion. Our first witness is Mr. George Terborgh, research director of the Machinery and Allied Products Institute.

Mr. Terborgh, it is a pleasure to have you with us today and you are recognized.

STATEMENT OF GEORGE TERBORGH, RESEARCH DIRECTOR, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. TERBORGH. Thank you, Mr. Chairman.

This panel is invited to discuss a question at the moment quite hypothetical: What kind of tax reduction should we have if we had one?

The reduction contemplated by this hypothetical question is clearly not for the purpose of stimulating the economy during a recession. To quote the committee's release, it is one that appears "desirable in the interests of continuing economic growth." This I construe to mean a reduction with long-range, rather than immediate, objectives.

Since we know neither the surrounding circumstances nor the dimensions of this conjectural tax abatement, it is obviously impossible to present a specific program. The most that can be done is to suggest a few guidelines or general principles. That is all I shall attempt.

AUTOMATIC STABILIZATION

Let me begin with the first of the three suggestive questions supplied the panel. What types of tax changes would enhance the automatic stabilizing capacity of the Federal revenue system?

I may observe with due deference that this is a loaded question. It takes for granted that the "enhancement of the automatic stabilizing capacity" of the tax system is conducive to the previously stated objective of promoting "continuing economic growth." This is in my judgment a false assumption.

Let me quote at this point a distinguished authority, the assistant to the Secretary of the Treasury, Prof. Dan Throop Smith, of Harvard University:

> A tax structure designed to have extreme flexibility would be very likely to place undue emphasis on the very taxes which are the most repressive on the incentives needed for long-term economic growth. * * * There is likely to be a direct contradiction between the objective of built-in flexibility in a tax system and the objective of minimum tax repression of incentives for long-term growth.

We could enhance the cyclical flexibility of the Federal tax structure by further stepping up the rate progression on individual incomes and by raising the corporate rate. But a tax structure must attempt a workable compromise among conflicting objectives. It cannot pursue any one of them to the exclusion of others. We have already gone very far in the direction of cyclical flexibility—to the prejudice of other goals.

The Federal Government gets more than 80 percent of its tax revenue from personal and corporate income taxes, a percentage without parallel, I believe, in any other important country. The rates on personal income go to 91 percent. The corporate rate is 52 percent. These are among the highest in the world.

Let me add parenthetically that insofar as they apply to business income these rates are even higher than appears. This is because income accounting for tax purposes fails to recognize the effects of inflation, hence understates the real cost of capital consumption. For example, if we restate last year's corporate taxable income to allow for the true cost of inventory and fixed-asset consumption, the effective tax rate was nearly 60 percent, instead of the stated 52 percent.

Such tax rates not only have a repressive effect on incentives for long-term growth, as Professor Smith has pointed out; they have a repressive effect also on the ability of the economy to finance growth. Let me comment briefly on these two effects.

As to the effect on the incentive for productive investment, I shall have to ask your indulgence for a statement I cannot possibly document in the space available here. My studies indicate that a corporate rate of 52 percent extends the normal service life of productive facilities, as compared with their life in the absence of the tax, by an average of something like 20 percent. They have to get older and more decrepit before it is economical to replace them. By thus reducing the incentive for the renovation and improvement of productive capacity, the tax slows down the advance in productivity and the standard of living. It is a drag on progress.

This disincentive effect would obtain even if the tax system as a whole had no adverse impact on the supply of funds for financing progress. But the system does have such an impact. As the committee knows, most of the saving of the American economy is done by corporations and by individuals in the middle and upper income brackets. The present structure of corporate and personal rates is admirably contrived to bite into this saving. Thus the structure has a scissors effect: It impairs the incentive for productive investment while curtailing the wherewithal to finance it.

I should like to suggest that the second effect is at present even more serious than the first. Notwithstanding the drag of high tax rates on investment incentives, the demand for capital is prodigious. We are in the midst of a technological explosion, sparked in part by an unprecedented expenditure on research and development, which opens vast opportunities for new investment. The economy is not generating enough saving to accommodate this demand without acute strain on our credit facilities. We very much need an abatement of taxes on saving.

I have given this first question too much time, and I come at once to the conclusion. Far from enhancing further the "automatic stabilizing capacity" of the Federal tax structure, we should seize the earliest opportunity to execute at least a modest retreat from the present position in the interest of long-run economic growth. Specifically, we should give high priority to a revision of the absurdly high upper-bracket rates on personal income and to a reduction of the corporate rate.

NEW AND SMALL BUSINESS

The second question offered for the guidance of the panel concerns the kind of tax changes desirable "to reduce tax-induced distortions in resource allocation." I have been out of the academic world too long to wrap my mind around that one, and with the indulgence of the committee will leave it for the professors. I may say a few words, however, on the third suggestive question. What types of tax changes would improve the competitive climate for new and small businesses, both corporate and noncorporate?

I propose to comment on only one phase of the so-called small-business problem. In its tax aspects, this problem is usually discussed in terms of comparative rates. I believe that in many cases the rate question is less important than the question of getting tax benefit for operating and capital losses.

With the present 2-year carryback and 5-year carryforward, a large enterprise is in a position to take on a risky venture with reasonable assurance that, if it fails, operating losses can be beneficially offset against prior or subsequent income from other sources, and capital losses can be offset against capital gains realized elsewhere. If this same venture is organized as a small independent business, however, there is no such protection. In the event of failure, both the operating and the capital losses may be taken with no tax benefit whatever.

I believe this exposure of small business—and especially new business—to the risk of nonbeneficial losses deserves more attention than it has received. Rate concessions, while they mitigate the risk, do not remove it. Some more direct attack on the problem is desirable, and the possibilities along this line should be carefully explored.

Thank you.

Representative MILLS. Thank you, Mr. Terborgh.

Our next panelist is Mr. Harry J. Rudick, attorney, Lord, Day & Lord.

Mr. Rudick, we are pleased to have you with us and you are recognized.

Mr. RUDICK. Thank you, Mr. Chairman.

STATEMENT OF HARRY J. RUDICK, ATTORNEY, LORD, DAY & LORD

Mr. RUDICK. I respectfully suggest that the most urgent item on the congressional fiscal policy agenda should be reform of the tax structure. The effectiveness of our tax system depends to a very large extent on the willingness of taxpayers to submit to it; and unless we take steps to nip in the bud the burgeoning seed of disrespect and resentment toward the tax law, the system may deteriorate seriously if not break down. It is not merely that the burden is extraordinarily heavy. People will bear a huge burden if they believe it is being distributed fairly, but they will balk if the notion becomes widespread that some are enjoying privileges not available to the many. More and more people are coming to realize that persons with equal incomes do not invariably pay equal taxes. To take a concrete example, under the present income tax law, an inventor of toys may reap the financial rewards of his ingenuity at the favorable capital gain rate (that is, he pays tax on only half of such income and in no case may the tax exceed 25 percent thereof) while a writer of books for juveniles who may give just as much pleasure and instruction to children is required to pay at the ordinary rates of tax. One can hardly blame the writer if in the face of this unequal treatment he takes advantage of every avoidance opportunity, intentional or unintentional, which the law allows; and even if he cheats a little, he probably squares his conscience by reflecting on the fact that the law unfairly favors someone else over him. Laws have to make sense and if they do not, people will tend to disregard them. I can see no persuasive reason for preferring taxpayers whose brain children consist of patentable ideas over taxpayers whose minds produce unpatentable ideas. Nor do I see any good reason for preferred tax treatment to people whose income stems from property as distinguished from those whose income stems from personal effort. By and large, taxpayers who inherit or are given property fare better under the present tax law than those who earn it.

Our tax laws are riddled with preferences similar to those I have described; preferences and distinctions based not on discernible economic differences but on formal variations and often stemming from wholly specious reasons. An example of the latter is the allowance of percentage depletion on gas, oil and other mineral deposits beyond the cost of the property. Referring specifically to oil and gas, I do not see how anyone can seriously believe that corporations and individuals will stop exploring for oil if we limit depletion to investment, continuing, however, to allow percentage depletion up to that point and continuing to allow the current chargeoff of intangible drilling costs.[1] Because of long-established precedent and because of the large number of States with oil, gas and other mineral deposits, it is too much to hope that this intended but unjustified subsidy will be taken away. Probably the only practical method of correcting the situation will be by giving some equalizing allowance to recipients of other forms of income; just as we solved the problem of equalizing the tax burdens of married couples in the so-called community property States with married couples in the other States by adopting split income. Incidentally, split income also solved the problem of equalizing the tax burdens of married couples where one spouse supplied the bulk of the family income with the burdens of couples where both spouses contributed substantially.

Whether explicitly or tacitly, the factor which serves as justification for what has been called the erosion of the tax base and the gimmicks in the tax law which grant certain groups favorable tax treatment is the extremely high rates. The upper reaches of the income tax brackets provide a relatively insignificant amount of revenue. Yet they cause the trouble. (Many writers have pointed out that because of the permissible exclusion of cerain types of income and the allowance of special deductions, most high bracket taxpayers—except those who derive the bulk of their income from services—pay a far smaller percentage of their income in tax than the rate schedule would imply.[2]) If we assume that it is possible to transmute ordinary income into capital gain and if the difference between the rate applicable to capital gains and that applicable to ordinary income is as high as 66 percent—as it is under the current income tax law—the discrimination is much greater and is far more resented than if the differential were only half that percentage. If we must have discriminations, and we will have to have some for the sake of expediency, let them at least be as small as possible. We need not make a foolish fetish of tax equality and carry it to extremes—the tax law cannot redress all the injustice of the world. We have to balance equity against administrative cost and convenience. But, as I have said, if the differential in tax burden is minimal or at least relatively small, there will be less resentment and less flouting of the law.

It is probably impracticable to cut the rates for upper bracket taxpayers without at the same time doing something for lower bracket taxpayers; and to cut the rates for lower bracket taxpayers results in very large losses of revenue. Therefore, I believe that Congress should not undertake any large-scale reform of the tax structure until it is prepared to accept a truly significant revenue cut, at least $3 billion and preferably $4 billion. At that time—and I submit that the timing should depend not merely upon budgetary or other fiscal con-

---

[1] At the time (1926) percentage depletion beyond investment was first permitted, the rates of tax were far lower—ranging from a minimum of 1½ percent to a maximum of 25 percent—so that the amount of the subsidy was tremendously less than it has since become.

[2] See, for example, the papers submitted to this subcommittee by Blum, Cary, Atkeson, Groves, and Paul in 1955 and published in Federal Tax Policy for Economic Growth and Stability (papers submitted by panelists appearing before the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, 84th Cong., 1st sess., Nov. 9, 1955, pp. 251–313).

siderations but on the growing peril to the tax system—I would do the following simultaneously:

1. Increase the allowable exemptions from $600 to $700 but allow all exemptions only against the first $4,000 of taxable income ($8,000 for married couples filing joint returns).

2. Reduce the tax on the first $2,000 of taxable income to 18 percent; reduce the remaining brackets—the upper brackets being reduced more proportionately than the lower ones—until a top bracket of 60 percent is reached at, say, $200,000 ($400,000 for married couples).

3. To compensate for the reduction in rates, eliminate the special exclusions and deductions and other preferential provisions (including the dividend credit) now given to certain taxpayers except in the relatively few cases where the privilege can clearly be justified by offsetting savings in administrative trouble and expense or by overwhelmingly popular consensus.

4. Cut the present corporate rate of 52 percent to 50 percent and eliminate the preferential rate applicable to the first $25,000 of a corporation's taxable income. At the same time remit completely the tax on any closely owned corporation whose shareholders agree to be taxed on their proportionate shares of the corporation's profits. Assuming revision of the rates as proposed above, the tax burden on small corporations owned by less than wealthy stockholders would be materially reduced.

5. The rates of the transfer taxes (gift and death duties) particularly the higher brackets, should be materially reduced but the yield of the tax should be maintained and even increased by tightening the structure of the transfer taxes to prevent the very significant avoidance which is presently possible.

6. Except for the taxes on liquor, tobacco and gasoline, eliminate the present selective excise taxes which now have nothing to support them except fortuitous precedent and administrative experience and substitute a general excise tax which would produce approximately the same amount of revenue.

In a separate statement which I shall submit for inclusion in the record, I have elaborated on the foregoing proposals.

Representative MILLS. Without objection the additional statement will be included in the record and we thank you, Mr. Rudick.

(The statement referred to follows:)

SUPPLEMENTAL STATEMENT BY HARRY J. RUDICK

1. *Exemptions.*—In view of the decline in the value of the dollar, the exemptions allowable under the present law are for most taxpayers the lowest ever and should be increased. However, I see no need or justification for an additional exemption for taxpayers with large incomes who are over age 65 and for wealthy blind persons. The announced basis for the additional exemptions allowed such taxpayers is that they have increased living expenses. The premise is questionable. But even if it were correct, an elderly or blind taxpayer with $100,000 of income certainly does not need an extra exemption. In fact, since exemptions presumably reflect an estimate of the bare essentials of living costs, I see no need to extend them to any but the lowest brackets. Accordingly, I would allow exemptions as an offset only against the first $4,000 ($8,000 for married couples) of taxable income (before reduction by exemptions). This would materially cut the revenue cost of increasing the exemption. Whatever the gross cost, the net cost would be less because part of the remitted tax would flow into consumption and part of that flow would come back into taxable income.

2. *The rate structure.*—Under the present law the ratio of total tax to total net income, if we ignore the moderating effect of exemptions and the standard

deduction—this effect gradually lessens until it becomes minuscule in the higher brackets—ranges from a minimum of 20 percent to a maximum of 87 percent.[1] Anyone familiar with the situation of high-bracket taxpayers who derive virtually all of their income from services will know that after paying their income taxes[2] and their living expenses—which inevitably increase as income increases—the amount left is too small to permit the accumulation of significant amounts of capital. The result is that fewer and fewer individuals go into business for themselves—at least businesses where a substantial amount of capital is required. When rates from 50 percent to 87 percent are imposed on incomes between $32,000 and $200,000 (for married couples), the point of diminishing returns as probably been passed as to such taxpayers; not so much because they quit work to loaf—I do not believe that there has as yet been a sufficient slackening of effort as a result of the extremely high rates to have any pronounced effect on economic activity—but because the persons in these brackets constitute to an important extent the driving force of the economy. By this I mean that the individuals in this group—at least those whose principal source of income is personal effort—supply to a far greater degree than average the imagination, industry, and initiative which are essential to the maintenance of a stable and growing economy. They are the ones who, if they could, would be prepared to start new ventures and supply risk capital; and if they are unable to accumulate capital out of their earnings,[3] they are prevented from striking out on their own or otherwise utilizing their talents fully. In either case, the economy is the loser. Moreover, the severity of the upper bracket rates serves as justification for the increasing number of "relief" provisions which have been enacted to temper this severity. If these "relief" provisions as well as the exclusion of certain items from gross income and the allowance of certain special deductions were eliminated, I believe that the reduction of rates for high-income taxpayers would be offset to a very large extent. In any case, the income tax would be a fairer tax and even if some differentials were retained, as they will have to be because of administrative expediency or some other factor, the disparity would at least not be as great. Under the next heading, I shall refer to some of the preferential provisions which I think should be repealed.

3. *Provisions which reduce the tax base or give other preferential treatment.*—The provisions which gives preferential treatment to certain groups of taxpayers or certain types of income are too numerous to list. The following will serve as illustrations:

(*a*) To begin with an example which affects low-bracket as well as high-bracket taxpayers, I see no compelling reason to exclude sick pay (it is now excluded to the extent of $100 a week) from gross income. Apart from extraordinary medical expenses which are allowed as a deduction anyway, a person who is confined to his home ordinarily incurs less expense than one who is on the job, if only by the cost of getting to work. Why a working taxpayer should pay more tax than a nonworking one is beyond me. The present law provides

---

[1] The following table shows for certain taxable levels the marginal rates and the average rates:

Taxable income	Married couples		Unmarried individual	
	Marginal rate	Average rate	Marginal rate	Average rate
	Percent	*Percent*	*Percent*	*Percent*
$16,000	30	25	47	33
$28,000	43	30	62	43
$52,000	59	41	75	54
$76,000	65	48	81	62
$100,000	72	54	87	67
$300,000	89	75	91	82

NOTE.—The highest marginal rate is 91 percent; the highest average rate is 87 percent.

[2] In many States the Federal impost is supplemented by local income taxes. The effective rate of local income taxes will be less than the nominal rate because of the fact that the local income tax is deductible from gross income in computing the Federal tax.

[3] It is evident that equity capital is being supplied to a growing extent by institutional investors and that the ratio of private investment to total investment is declining. Factors Affecting the Stock Market, Report of the Senate Committee on Banking and Currency, S. Rept. No. 1280, 84th Cong., 1st sess., p. 95, table 4 (1955).

an incentive for anyone who receives his full pay even though he does not show up for work, to be sick and stay home.

(*b*) Assuming a much more gradual increase in the rates and the suggested top rate of 60 percent, favorable capital gain treatment should no longer be extended to (1) recipients of restricted stock options, (2) recipients of pensions and profit-sharing distributions (now allowed under certain circumstances), (3) inventors, (4) owners of certain depreciable property, (5) breeders of cattle and other livestock, (6) owners of timber and coal, (7) transferors of certain oil payments, (8) owners of certain real property subdivided for sale, (9) amounts received on the cancellation of a lease or distributors agreement, and (10) owners of unharvested crops (now allowed under certain conditions).

Here let me say that I am not in favor of completely abolishing the favorable treatment of capital gains. The appropriate income tax treatment of capital gains has been a most vexing and controversial problem. The chief difficulties arise because (1) a nominal capital gain may not represent a true capital gain but rather a reflection of the decline in the value of the dollar and (2) because of the fact that a capital gain may have accrued over a long period of time and if the entire appreciation is taxed in the year of realization, the resultant tax will ordinarily be very much larger than if the increment had been realized ratably and taxed annually over the holding period. The first source of difficulty could be overcome by providing that the cost (or other basis) of the property which produces a capital gain should be adjusted to reflect changes in the value of money during the holding period. But the second difficulty could only be overcome by some system of averaging and I am not in favor of averaging as a general proposition for two reasons: first, because it would tend to produce undesirable economic effects (reduced tax collections in an inflationary period and increased tax collections in a deflationary period) and second, because the administrative difficulties of a general averaging system would be too great to compensate for the possible advantages.

I think the present method of requiring the inclusion in taxable income of one-half of a capital gain is about as good an approximation of tax equity as we can practicably work out for capital gains, assuming, of course, that the definition of capital gain is much more restricted than it now is If the rates of tax were adjusted as I have suggested (with a top bracket of 60 percent), it would be possible to eliminate the alternative computation now provided for. Then, for the highest bracket taxpayers, the effective rate of tax on capital gains would be 30 percent as against the present maximum of 25 percent. I would also favor requiring a holding period of at least 1 year as compared to the present 6 months.

(*c*) As indicated in my oral statement, the allowance of depletion beyond cost, of gas, oil and other mineral deposits should be terminated. (At present, such depletion is allowed against even such virtually inexhaustible deposits as clay, stone, etc.)

(*d*) The exemption of income from investment in State and municipal bonds should be taken away, but only as to future issues of such bonds. At the present time, an appealing case can be made for the continued exemption of the interest on State and municipal bonds because of the compelling need for local improvements, principally schools. The financing cost of such improvements would be increased if the exemption is taken away. However, in the long run, it is difficult to justify the immunity. It materially reduces Federal tax revenue and thus prevents lower rates than might otherwise be possible. It arouses a sense of inequity in taxpayers who cannot take advantage of the immunity. To my mind, these factors certainly justify the higher borrowing costs which local governments would have to pay.

(*e*) The immunity from tax (except as capital gain) of certain nonliquidating dividend distributions by corporations which have no earnings or profits should be repealed.

(*f*) The investment factor of life insurance should not enjoy complete immunity; and pension funds and profit-sharing plans should be made to pay some tax on their investment income. The present law discriminates against those who cannot or do not take out life insurance with investment features and against taxpayers who are not fortunate enough to be participants in pension plans.

4. *Corporation taxes.*—As my oral statement indicates, I would not reduce the corporate rate except for a token percentage. In other words, I would like almost all of the available area of tax reduction to go to individuals rather than to corporations. I believe that, for large publicly owned corporations, the corporation income tax has become imbedded in the price structure. Man-

agement is interested in how much money will be available for stockholders after taxes and they will, so far as they can, fix their prices at levels which will produce a desirable return for their shareholders. I think that, even for closely owned corporations, the corporate income tax has generally become a component of cost and that most of the burden is passed on to consumers. Moreover, a high corporate tax has some beneficial effects in that it tends to induce economic activity which might otherwise not be undertaken. At a 52 percent (or 50 percent) rate, certain expenditures become prudent which might otherwise be imprudent. A deductible dollar costs only 48 cents, and tax-oriented business judgment is an inevitable consequence of this disparity. If a dollar cost only 48 cents, that frequently makes it wise to do things and take risks which perhaps would not be undertaken if the full dollar cost were incurred. I used to think that this was bad. However, I have come around to the view that a rate of corporate tax as high as 50 percent is not necessarily bad, since it tends to stimulate such activities as sales promotion, research, and new product development, and these activities in turn generate jobs and income. I would guess that the resulting stimulation of economic activity more than compensates for the reduction in consumption which results from increased prices or lower dividends.

Much is heard about the plight of so-called small corporations. So far, no one seems to have worked out a universal definition of a small corporation. A small automobile corporation has to be many times as large as a small retail store. At any rate, the present preferential rate of 30 percent applicable to the first $25,000 of taxable income has not been particularly helpful to the formation and survival of small businesses. Yet proposals have been and still are being made which would graduate the corporate tax still further. I do not believe that such action would do much toward stimulating the growth and survival of small corporations. If the corporate rate were graduated still further, large- and medium-size businesses would simply subdivide themselves to obtain the benefit of the lower rates, and I am sure it will be found extremely difficult to draft workable laws to prevent such subdivision. I think the problem can be approached more effectively by having a single corporate rate and allowing any closely owned corporation to be exempt from all corporate income tax if the shareholders consent to report as taxable income their proportionate shares of the corporation's profit, that is, as if the corporation were a partnership. This will mean that those stockholders who are wealthy will pay a higher tax on their share of the corporate profits, while those who are in low brackets will pay only a modest amount. Any dividends paid by such a corporation to the electing shareholders would be tax free. I would further provide that any losses sustained by such shareholders should, to the extent of their investment (including reinvested profits), be allowed as an ordinary deduction rather than as a capital loss.

5. *Estate and gift taxes.*—As in the case of the income tax, the estate- and gift-tax rates go up to quasi-confiscatory levels. However, there are so many available means of avoiding or minimizing these taxes that the actual yield of the taxes is only a fraction of what one might expect from the scale of rates.[4] There is not much sense in having extremely heavy rates if only the extremely naive pay them.

By judicious management, very large amounts can be transferred to one's heirs without the payment of any gift or estate tax. Unfortunately, not all persons with estates large enough to be in the range of tax are so situated as to be able to take advantage of the avoidance possibiilties. I suggest that, as in the case of the income tax, the rates be reduced to more realistic levels and that the avenues of avoidance be closed. If this were done, I think the yield of the tax could be appreciably increased. Among the avoidance methods that should be studied are:

(*a*) The possibility of substituting a tax on a graduated and cumulative basis against what each donee or heir receives, regardless of when and from whom.[5]

---

[4] The estate-tax rates range from 3 to 77 percent of the taxable estate. (A 30-percent rate is reached at $100,000.) The gift-tax rates range from 2¼ to 57¾ percent.

[5] Rudick, What Alternative to the Estate and Gift Tax? 38 Cal. L. Rev. 150 (1950); Rudick, A Proposal for an Acquisitions Tax, 1 Tax L. Rev. 25 (1945).

(*b*) An integration of the gift and estate taxes in a single transfer tax so that the tax would be the same whether the owner gives away the property during his lifetime or at his death.[6]

(*c*) The elimination of the disparate treatment of transfers in trust and outright transfers. (Under the present law, if A gives his property to his son for life, the remainder to his son's children, only one transfer tax is payable; whereas, if A gives the property outright to his son who in turn leaves property to his children, two taxes are payable.)

(*d*) Revision of the too liberal gift-tax exclusion provisions.

(*e*) Limitation of the now unlimited exemption of transfers to private foundations as distinguished from quasi-public institutions not privately administered.

6. *Excise taxes.*—The taxes on liquor, tobacco, and gasoline are traditional and virtually universal. People expect and do not resent them. Moreover, the products taxed create certain general-welfare and law-enforcement problems which go part way to justifying taxing them. However, the other excise taxes, except possibly that on automobiles and except certain taxes which are imposed primarily for regulatory reasons like the taxes on firearms and narcotics, cannot be justified on any other ground than expediency, that is, the fact that the products were once taxed and it is easy to go on taxing them. Many of the items, e. g., watches and luggage, were originally taxed not so much for revenue as to deter the use of materials which were scarce and which were vitally needed for defense and war purposes. Nevertheless, such items continue to be taxed even though the scarcity of material no longer exists.

With the exception of the taxes mentioned, I would like to see all of the excises replaced with a general excise tax if it is concluded that one is needed for revenue purposes. To avoid overlapping of local sales taxes, I would impose the tax at the manufacturer's level and, to avoid pyramiding, I would make "value added" the measure of tax.

Representative MILLS. Our next panelist is Prof. Richard A. Musgrave, department of economics, University of Michigan.

Professor Musgrave, you are recognized.

STATEMENT OF RICHARD A. MUSGRAVE, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. MUSGRAVE. I have been asked to discuss what types of tax reduction should be undertaken if and when taxes are to be reduced. I do this with some hesitancy, since I do not favor tax reduction at this time. Nor do I think we should commit ourselves now to cut taxes next year.

EARLY TAX REDUCTION NOT CALLED FOR

Tax reduction will be called for when there is a distinct downturn in economic conditions, or when there occurs a substantial cutback in public expenditures, not before.

As yet, I do not see the signs of a developing recession which calls for early tax reduction. When it comes, I shall be strongly in favor of tax cuts, and I would like to see increased flexibility in tax adjustments to permit prompt action. But now is not the time for reduction. As long as the economy continues at its present bouyant level, tax reduction will only increase the need for tight money; and it will increase the already existing imbalance between monetary and tax restriction.

Moreover, it will make it more difficult to check inflationary pressures from the cost side.

[6] Federal Estate and Gift Taxes, a proposal for integration and for correlation with the income tax, a joint study prepared by an advisory committee to the Treasury Department and by the Office of the Tax Legislative Counsel, with the cooperation of the Division of Tax Research and the Bureau of Internal Revenue (U. S. Government Printing Office, 1947).

Nor do I favor substantial cuts in expenditures. I am much disturbed by the growing bipartisan commitment of Congress to such a course; and I sympathize with the President's drive, if belated, in defense of his budget. Whatever can be done to increase efficiency in public expenditure programs should be done. This much is self-evident; but it appears that any substantial cuts will involve curtailment of programs, rather than efficiency savings. As a citizen, I do not favor a general curtailment of programs. As I see the world picture, I do not think that the American people spend too large a part of their budget for these things. I do not believe that the proposed level of defense spending is too high; and while I recognize that defense needs curtail what can be done along civilian lines, I do not feel that we should suspend such services. However, this is not the important point for today's topic.

The important point is that much of the current drive for cutting the budget is carried on under the banner that taxes must be cut because the current load is intolerable. I am not qualified to judge whether this is the case from a political point of view; and if so, what congressional leadership can do to persuade the people otherwise. However, I can judge the economic aspect of the matter, and I am convinced that the tax load is not intolerable in this sense. What seems to be the President's repeated nightmare—that we must walk a knife edge between military defeat abroad and economic disaster at home—is just a nightmare. It has no basis in fact, at least not in the present setting. To be sure, there could be a level of military expenditures which would set us back into a rigged economy of the wartime type, but current proposals are far below that. The gross national product in real terms is now about one-third above wartime levels, and we are looking back at a decade of unsurpassed prosperity. Far from being an impediment, the big budget has contributed to this prosperity.

If the Congress insists on severe cutbacks in the budget, let it be done for the right reasons: That is, not because economic necessity demands it, but because these outlays are considered less desirable than private uses of income. It is only fair to add, vis-a-vis our friends abroad, that these cutbacks need not be undertaken because the American taxpayer would starve lest his taxes be cut. Notwithstanding present levels of taxation, the American consumer has experienced a 55 percent gain (in real terms) in his income after tax since 1940, and a 20 percent gain since 1947. I expect these gains would continue, even though present rates of tax have to be maintained.

In the longer run, present tax rates will bring in a rising yield, as the level of national income rises. This will permit cuts in tax rates provided that defense requirements rise less rapidly than the level of national income. This is a happy assumption to make, but I see little basis for it. In particular not, if we consider that the Russian national income is likely to rise faster than ours. Such being the case, we should be very careful not to create unjustified expectations for tax reduction over the next few years. Such expectations will materialize only in the pleasant event that international conditions take a decided turn for the better; or, in the less pleasant event, that economic conditions turn down and a deficit is called for.

PATTERN OF TAX ADJUSTMENT

With this in mind, let me turn to possible patterns of modest tax reduction if and when the situation arises. Such reductions must be fitted into the longer run objective of improving and consolidating the tax structure.

Assuming a small reduction of $2 billion, I would propose the following type of adjustment.

1. Split first bracket of personal income tax into 2 brackets of $1,000 each, and cut rates on first bracket by 3 percentage points.
2. Limit top surtax bracket rate to 60 percent.
3. Apply source withholding to interest and dividend income, which in turn would provide some additional revenue. The same holds for some of the additional points which I am going to mention.
4. Other measures to tighten personal income tax.
5. Repeal 1954 dividend credit and exclusion.
6. Reduce corporate rate on dividends paid by 5 points.
7. Reduce depletion allowance.
8. Reduce corporation tax rate to 50 percent.
9. A modest reduction of excises.

If a more substantial cut were permissible ranging to $5 billion, I would supplement the above adjustments by:

10. Five percent cut in all bracket rates under the personal income tax, leaving upper limit at 60 percent.
11. Reduction in selected excises.

EQUITY ASPECTS

These adjustments are based on certain views as to what constitutes an equitable tax structure. Most important is the idea that we should preserve and improve the personal income tax as the core of the tax structure. For this reason, I favor that relief at the lower end of the income scale be given in the form of rate reduction, rather than by raising exemptions and dropping people from the tax base. Similarly, I favor that the treatment of higher incomes be made more equitable by reducing top bracket rates and taking measures to assure that such rates as remain will be applicable, not only to salary, but also to capital income. A number of the proposed changes work in this direction, although I have by no means listed all that should be done. In addition to removing existing inequities, we should resist all tendencies toward further erosion of the income tax base, including recent proposals to permit income tax reductions for expenditures on education. Of all forms of Federal aid to education, this seems to me one of the least desirable.

Apart from these adjustments in the personal income tax, I would like to see a modest cut in the rate of corporation income tax, again to be combined with a tightening of the tax base.

Also, as I mentioned, I should like to see a change in the 1954 approach to the divident credit. Finally, I suggest a modest reduction in excises, but secondary to the income tax adjustment.

EFFECTS ON BUILTIN FLEXIBILITY

The proposed plan for tax reduction will not increase the automatic stabilizing capacity of the budget. Nothing does more to enhance this capacity than to keep the budget big and taxes high.

If we think of stabilizing capacity per dollar of tax yield, we should do best by cutting out excises and payroll taxes, while increasing the progressive taxes in the system, especially those on capital gains. The proposed pattern does not meet this objective, nor do I think that it should.

I quite agree with Mr. Terborgh's statements on that point.

There are better ways to increase the flexibility of tax policy. In particular, I would urge consideration of a plan whereby authority to adjust the level of tax rates in a prescribed pattern, say, by raising or lowering the first bracket rate of income tax, would be delegated to the executive branch, the much discussed Monetary-Fiscal Authority, or to a joint executive-congressional group. If this were done, prompt adjustments in tax rates could be undertaken to meet changing business conditions, and this could be done without any loss of ultimate control over tax legislation by the Congress.

I think that an examination of a scheme of this sort would be a highly desirable thing to undertake.

Taxes are meant to have depressing effects, resulting in a reduction in private consumption and investment. A tax reduction, similarly, should release funds for investment and for consumption. The effects of tax reduction may be to enhance growth in two respects. Investment may increase because more funds become available for investment; or it may increase because investors find it more attractive to invest available funds. Some of the suggested changes will be helpful in both respects.

At the same time, the suggested pattern is not the one which I would propose if I were asked to consider favorable effects on growth only, while disregarding considerations of equity. In such a case, tax relief would be concentrated more heavily on capital income. The corporation tax might be cut more and capital gains taxation might be repealed. Better still, taxes might be raised and specific subsidies be given to investment where they are most effective.

I am not prepared to support such an approach. For one thing, I believe that equity is an important part of sound taxation; for another, sustained growth requires a high level of consumption as well as capital formation. Tax reduction which places exclusive emphasis on capital income, sooner or later tends to result in a situation where, in the absence of deficit finance, the economy can sustain neither a high level of investment nor a high level of consumption. Therefore, I favor a balanced tax reduction, providing for an increase in consumption as well as in investment.

Is budget cut inflationary or deflationary?

The type of tax reduction, finally, may have some bearing on whether the proposed cutback in the budget—including tax and expenditure reduction—will be an inflationary or a deflationary factor in the economy.

Traditional reasoning in fiscal theory has held that an equal decline in public expenditures and tax yield reduces the total—public plus private—level of demand in the economy. What I like to refer to as the Humphrey theorem holds that the level of income will rise. The former is the case if we assume that the resulting effects on investment operate via changes in the supply of available funds, in which case the increase in investment and consumption cannot exceed the reduction in tax yield. The latter may be the case if effects on investment operate via changes in profitability due to changes in tax rate, in which case, investment may rise by more than the reduction in tax yield.

If the latter interpretation were correct, the proposed reduction in expenditures, combined with reduction of taxes on investment income, might be inflationary in its net effect. Such at least might be the case in the short run, until the additional capacity becomes available. This is a conceivable chain of effects, but I do not think that it is likely. At the same time, I do not think that the cutback in the budget will have a substantial deflationary effect in the present setting of a highly buoyant economy. In this setting, savings find their way readily into investment, and more or less all private income is respent, be it for consumption or investment. In such a setting, a balanced cutback in the budget has little or no effect on total demand. However, should a recesson occur the resulting decline in income will be sharper than it would have been had there been no preceding cut in the budget. This is but another way of repeating what I have noted before, namely that cutting the budget reduces built-in flexibility.

Representative MILLS. Thank you.

Our next panelist is Mr. John F. Costelloe, the tax director of the Radio Corporation of America.

Mr. Costelloe, we are pleased to have you and you are recognized.

STATEMENT OF JOHN F. COSTELLOE, TAX DIRECTOR, RADIO CORPORATION OF AMERICA

Mr. COSTELLOE. Until today, this body and the representatives of academy, labor, and industry who have been privileged to appear before it, have addressed themselves to general matters of policy and finance.

Today we are to consider tax changes for steady economic growth. We are asked what kinds of tax changes would promote economic stability, reduce tax-induced distortions in resource allocation, and improve the competitive climate for new and small businesses.

We have been admonished that the panel is not to consider proposals for detailed changes. I make such proposals, but they are intended to be illustrative of general principles rather than being advanced merely for their own sake.

I submit that tax changes are in order for two kinds of pioneering business activity.

One is establishment of foreign markets and business.

The other is establishment of domestic markets for new products burdened with a Federal excise tax.

Each involves expenditures of resources in the hope of establishing new business. The United States taxes each without reference to the attainment of success. The revenue yield is small in comparison to the impediment to essential economic functions and development of new sources of revenues.

In the foreign field, a business conducted as an ordinary domestic corporation must pay full current rates of United States income tax, even on plowed-back earnings. This is true even though the country of operation has relatively low rates of income tax, and even though it has provided special tax relief. The United States cancels the benefit of the foreign rate by reducing the credit for foreign taxes.

In his most recent economic report to Congress, the President called attention to the incentive to private investment which would be provided by letting the taxpayer have the benefit of special foreign tax relief. Early in 1955, the President had urged that foreign income not be taxed until returned to the United States, and that it then be taxed at about the same rates provided for Western Hemisphere trade corporations. He said:

An increased flow of United States private investment funds abroad, especially to the underdeveloped areas, could contribute much to the expansion of two-way international trade.

The other two major capital exporting countries, Canada and Great Britain, have been actively concerned with current taxation of foreign income. Canada long ago exempted foreign-source income of a special kind of Canadian corporation from any Canadian tax. Some years ago it exempted from tax, dividends received by Canadian resident corporations from foreign corporation whose stock is held to the extent of 25 percent or more.

In 1955, a British Royal Commission recommended legislation which would exempt from current United Kingdom tax, foreign-source income of a special kind of United Kingdom corporation. That recommendation was similar to the unanimous recommendation for the United States by panelists in their appearance before this subcommittee in 1955.

There is now pending, United Kingdom legislation which would implement the recommendation of the Royal Commission. The parliamentary system gives assurance of enactment in due course.

Enactment of such legislation may be expected to increase the existing competitive disadvantages of United States businesses, a matter of great importance from each of the three standpoints listed in the schedule of hearings. Growth of foreign operations of United States business creates new markets for businesses of all sizes; new opportunities for labor, technology, and capital; and means for obtaining from abroad materials on which all depend.

Now, for the second kind of pioneering business activity to which I have referred, establishment of a domestic market for a new product burdened with a Federal excise tax. Here I hope you will forgive the express character of my illustrations. I think they are apt and I know they are accurate.

For several years black-and-white television sets were spared the excise tax imposed on sales of radio sets and other articles. In the years of untaxed sales the market developed so as to yield over $100 million in excise tax in the first year of tax on television sets.

On the other hand, the 10-percent excise tax was imposed on all-channel television sets and on color television sets from the beginning, and at a rate twice as high as that applied to most home appliances.

Bringing color television to the public has been enormously expensive. RCA has spent more than $100 million on color television so far, and in 1956 color television reduced its eanings by approximately $6 million, a large part of which went for Federal excise tax imposed on set sales.

New products are important to government as well as to business. For example, total RCA tax payments run about $4.20 for each dollar of common dividends; and, in 1955, 80 percent of the company's sales were of products and services not available to the public 10 years before.

In my view, wise tax policy would accord to all-channel television sets and to color television, freedom from the special burden of excise tax comparable to that accorded black-and-white television for several years.

I thank you.

Representative MILLS. Thank you, Mr. Costelloe.

Our next panelist is Prof. Lawrence H. Seltzer, department of economics, Wayne State University.

Professor Seltzer, you are recognized. We are pleased to have you with us.

STATEMENT OF LAWRENCE H. SELTZER, DEPARTMENT OF ECONOMICS, WAYNE STATE UNIVERSITY

Mr. SELTZER. During the past year and a half we have had a net cash surplus of several billion dollars in the Federal budget, and a tight monetary policy. Nevertheless, the total volume of spending, public and private, has been sufficient to produce rising prices and a high level of employment. So long as these conditions continue, we could reasonably contemplate making sizable reductions in total Federal revenues only if substantially equal cuts were to be made in Federal spending programs. The principal source of hope for such a development is that a new turn in international relations may soon permit a significant contraction in the major component of the Federal budget—the defense expenditures. If this should come to pass, and other Government spending programs are not enlarged, a roughly corresponding increase in private spending would be essential to sustain the level of economic activity.

Reduction in any one or all three of the largest sources of Federal revenues—the individual income tax, the corporation income tax, and the excises—would increase private spending, though possibly by more or less than the amount of the tax reduction; and reductions in any one or more of them would contribute to economic growth. Growth is promoted by fostering both investment and consumption. A reduction in corporation income-tax rates would contribute, at least in the short run, by enlarging the funds available for investment and by making investment more profitable. But investment responds also most powerfully to an expansion of the markets. And reductions in all three of the principal types of taxes would contribute to this result by increasing the disposable incomes of individuals (including the increased dividend income that could be reasonably expected from a lowering of corporation income tax rates).

Looking forward to the time when reduced expenditures may both permit and dictate revenue reduction, the practical problem, as in most economic questions, will not be to array the principal classes of taxes in the order of their generic merit for tax reduction and then to choose the foremost to the exclusion of the others. I am sure we shall want to reduce all three. The practical question will be whether we should reduce some more than others.

In distributing more or less permanent tax reduction among these three principal sources of Federal revenue, the desirable long-run shape of our tax structure should be an important guide. In 1956 we obtained about 47 percent of total internal revenue from the individual income tax, 28.4 percent from the corporate income tax, and 13.3 percent from the excise taxes. I ignore, for present purposes, the remaining 11.3 percent from the employment, estate, and gift taxes.

Because this relative distribution among the three principal tax sources has provided large and flexible revenues and has proved compatible with a high level of employment and income, and a good rate of growth, I think there is a reasonable presumption in favor of retaining it; that is, for reducing the revenues from the three principal sources in roughly equal proportions. This would seem to me a good working goal. It would be even better, I think, while cutting all three, to reduce our relative reliance upon excise and corporation income taxes. Some of the considerations that lead me to this conclusion are the following:

1. Although the proportionate share of the excise taxes in total internal revenue fell from 34 percent to 13 percent between 1939 and 1956, the absolute amount of such taxes more than quintupled, rising from $1.8 billion to $10 billion, and the total is scheduled to rise above $11 billion in fiscal 1958. While all taxes alter the distribution of expenditures, the excises do so with the greatest direct discrimination against particular goods and their producers and consumers. Moreover, many excise taxes get into business costs and are pyramided en route to the consumer.

Excise taxes on transportation and communications, from which we raised $1.2 billion in 1956, seem particularly objectionable on economic grounds. They directly impede a fuller use of the vast amount of fixed capital already in being to produce these services and the vast amount of other overhead costs that are being incurred willy-nilly to produce them.

As a group, excise-tax receipts are less sensitive to fluctuations in economic conditions than those based upon incomes. They therefore contribute less than income taxes to the automatic stabilizing influence of the Federal revenue system upon private incomes. Frequent statutory changes up or down in excise taxes are undesirable because of the competitive dislocations they produce. Finally, the State governments make heavy use of excise taxes. These considerations, in my mind, all argue for including excise taxes prominently among the candidates for Federal tax reduction.

2. Corporation income-tax revenues are highly sensitive to fluctuations in business. While open to objections on other grounds, the corporation income tax contributes in this respect to the automatic stabilizing influence of the Federal revenue system. But the present rates of the tax are undesirably high from a long-run standpoint. Wasteful corporate expenditures and those of doubtful merit are less apt to be curbed when as much as one-half or more of the cost is defrayed by the Government through reduced tax liability. The present scale of the tax makes it difficult for small and medium corporations to retain sufficient earnings for vigorous growth.

Economists know little in detail about the final incidence and effects of any tax, and perhaps least about the incidence and effects of the corporation income tax. We have good reason to believe that the direct burden of the tax tends to be shifted to the consumer in some industries, notably the regulated public utilities, and to be shared in varying degree between stockholders, customers, and suppliers of goods and services in others. Insofar as the tax is borne by stockholders, the nominal rates are the same for small-income and large-income stockholders. When consideration is also given to the personal income tax on dividends and the absence of such tax on retained corporate earnings, the combined rates are higher than on their other kinds of income for some stockholders and lower for others.

Almost any tax, however imperfect, is tolerable at moderate rates, but high rates magnify the imperfections. The corporation income tax was 12 percent in 1929, 18 percent in 1939 for income above $24,0000, and it is 52 percent today.

To my mind, the upshot of these considerations is that we should work toward a substantially lower scale of corporation income taxes.

3. The most important change that took place in the enormous expansion of the Federal revenue system since 1939 was the rise of the individual income tax to a preeminent position as a source of Federal revenue. Receipts from this tax rose from a little more than $1 billion, or less than 20 percent of total internal revenue receipts in 1939, to more than $35 billion, or 47 percent of such receipts, in 1956.

The present rates are heavy and should surely be reduced as promptly as possible. At the same time, I think we should retain or even increase the relative position of this tax.

The incidence of the individual income tax is more clearly known than that of the others, and its burden may be distributed more surely in accordance with the intentions of Congress among the different income groups. Because of its present wide coverage, extending to about 70 percent of our population, including dependents, and the sensitiveness of its revenues to fluctuations in employment and incomes, it is a potent automatic stabilizing element. Congress may also adjust its rates downward or upward, as the economic situation may indicate, with large and prompt results, and without the disruption of competitive relations or capital values than would tend to result from frequent changes, for short-run purposes, in excise and corporation income-tax rates. But the strength of the individual income tax depends in large degree upon its wide coverage. This suggests that tax reductions in this area should take the form more largely of rate reductions than of enlargements of the personal exemptions.

In the light of these considerations, therefore, a workable and desirable proximate goal in tax reduction would be to reduce all three of these major classes of tax revenues in roughly equal proportions, though leaning toward a greater relative reduction in excise and corporation income taxes than in the individual income tax.

Representative MILLS. Thank you, sir.

Our next panelist is Mr. E. G. Collado, treasurer of the Standard Oil Company of New Jersey.

Mr. Collado, you are recognized. We are pleased to have you with us.

STATEMENT OF EMILIO G. COLLADO, TREASURER, STANDARD OIL COMPANY OF NEW JERSEY

Mr. COLLADO. Thank you, Mr. Chairman.

No opportunity for tax reform should be wasted. If opportunity presents itself for tax reductions in the near future, then some effort should be made for reforms in the structure of our taxation of both domestic and foreign income.

Before getting into the foreign field, let me first state my agreement with the need stated by other witnesses for two basic reforms in the domestic field. I do agree reduction is needed in the high graduated rates of taxation of personal income. I also agree reduction is needed in the double taxation involved in the high corporate taxation of income which is to be taxed again at the individual level.

In the case of foreign income there are now in our tax law several features which limit the impact of United States taxes. Most important, foreign income taxes may be credited against the United States taxes which would otherwise be payable on income from abroad. These provisions provide the United States investor with substantial freedom from double taxation on income from abroad. This situation would be drastically changed, of course, if the foreign tax credit were eliminated. If United States law took no cognizance of foreign taxes at all, then in many cases United States investors would find their total tax bill to be considerably larger than their total income.

Despite the foreign tax credit provisions, there are still two basic defects in our system of taxing income from abroad.

First, the decisions as to when foreign income is taxed are now inconsistent. The income from an investment made by a branch of a United States corporation in a foreign country is taxed currently by the United States even though all the income is invested in that country as it becomes available, and even though none is returned to the United States. Yet at the same time the income in a neighboring country from a similar investment by a local corporate subsidiary of the same United States corporation is not taxed currently by the United States when all the income is reinvested and none distributed as dividends. This distinction seems all the more arbitrary when it is realized that the choice for the investor between using a branch or a foreign subsidiary is often dictated by local government regulations or political conditions in the country in which an investment is being made. To remove the inconsistency the proper course would be for the United States to follow the path already used by Canada and now being adopted by the British Government. In April of this year the Chancellor of the Exchequer announced his plan that the income of British corporations deriving all their operating income from abroad be exempt from tax until it is distributed as dividends.

Second, we need some basic rethinking of the principles which should be applied in determining how much United States tax should be added on top of the foreign taxes which have been paid on income earned abroad. The present system is right in providing that United States taxes should not increase an investor's total tax burden above the high rates prevailing on investment in the United States. But the present system is wrong in insuring that all income from abroad must pay combined taxes at least as high as the domestic United

States rates, regardless of the level of the applicable foreign taxes. There should be some way in which our law could allow the total combined tax rate to be influenced by the lower rates of tax, and of Government services, now existing in some foreign areas.

In 1954 the Secretary of the Treasury announced his willingness to propose modifications in the United States tax system in particular cases by treaty to provide that the effective United States tax rate on income from investments in a country would not be raised when that country lowered its tax rate for a limited period to attract investment. So far no treaties have been signed. The effort should continue but it should not be expected to make more than a small dent in the problem.

A simple way of cutting at the roots of the problem would be to extend to investment of other types and in other areas the 38 percent corporate tax rate now applicable to certain kinds of United States investments in the Western Hemisphere. The 14-point rate reduction involved in this action would be small compared to the rate reduction now proposed by the British Government for some of its investors abroad. It is proposed to exempt overseas trade corporations from the profits tax. For individual British shareholders of such companies this action will be equivalent to a 35½-point reduction in the corporate tax rate on income from abroad.

Both the deferral procedure and the rate reduction which I have recommended are the same which the President has been recommending to the Congress since 1954. The considerations of principle have been strongly reinforced by our interest in economic development abroad and our search for less costly and more effective alternatives to foreign-aid programs. Increasingly there should also be concern that United States investors are not denied access to economic opportunities abroad—opportunities which could bring rewards, not only to the investors, but also to our economy and our Government.

It is not easy to predict what would be the cost of the proposed reforms, for the Treasury hasn't made the necessary data available. In 1954 the Treasury did estimate that the changes it proposed in taxing foreign income would result in a $150 million revenue loss. At first glance one might expect the possible loss would be larger now since foreign investment has been growing. Actually, the loss might be smaller, since some foreign governments have been availing themselves of our Government's open invitation to raise their taxes on United States investments almost entirely at the expense of the United States Government's revenue. The time could come when the Treasury would be collecting no corporate tax on income from abroad. Corporate tax would, of course, also be foregone if the rate were reduced to 38 percent, but with an important difference. When the corporate tax revenue is reduced by rate reductions the difference becomes available to the corporations for distributions as dividends to be taxed by the United States. But when there is an induced rise in foreign taxes then the Treasury loses both corporate taxes and individual taxes.

These same considerations are also relevant to other aspects of foreign taxation. In the belief that they would increase Treasury revenue, some have suggested that percentage deplation allowances should be taken away from United States companies on their operations abroad. But this discriminatory action would not only ignore the national security interest in United States participation in a healthy oil industry abroad but also would probably backfire. Some foreign governments would find ways of insuring that the increased costs to the private companies went into the public coffers in the producing areas rather than to the United States Government.

Some of these considerations are illustrated in the experience of the company for which I work. In 1954 Jersey Standard and those affiliates of whose common shares Jersey owns more than 50 percent had a liability to the United States Government of $30.5 million on income from abroad. By last year foreign taxes had grown so large that these same companies had the smaller United States tax liability of about $20.2 million on foreign income. Last year these companies paid to foreign governments or collected for them a grand total of more than $1.7 billion in taxes and other payments required to conduct the various phases of the oil business. Of these payments $310 million were income taxes. These calculations do not include the foreign taxes paid by those companies in which Jersey holds 50 percent or less. There is excluded, for example, a little less than $200 million which was paid in foreign income taxes last year by Aramco, a company in which Jersey has a 30 percent interest. The 4 parents of Aramco did, however, pay $24 million in United States taxes on their dividend income from Aramco.

We estimate that Jersey's United States tax bill would have been reduced by $9.8 million in 1954 if a 38 percent tax rate had been applied to all foreign income. Last year, despite a much larger foreign income, the tax reduction would have been smaller, about $9.3 million. The reduction for future years could well be even smaller.

The unfortunate effects of our present taxation of foreign income cannot be measured simply by its self-destroying characteristic. It is important to consider the retarded economic growth of the private economies of the free world abroad. The present system distorts and hinders the flow of private investment by offsetting the low foreign tax rates which often accompany risky areas for foreign investment. This is certainly true for the Jersey company; we consider relative after-tax rates of return in deciding upon our investments in different areas of the world. I am sure the situation is similar for most other investors. It is true, moreover, not just for the net outflow of new private investment from the United States; it is true for the entire larger sum of the gross private capital expenditures abroad. Last year the gross private United States capital expenditures abroad were about $5 billion. This was a sum which contributed greatly to the free world's economic advance. A combination of tax reform in the United States and improvements in the climate for private investment abroad could lead to a significant expansion in this foreign private investment. Such an expansion would carry with it incalculable benefits to the United States to all other parts of the free world.

Representative MILLS. Thank you, Mr. Collado.

Our next panelist is Mr. Stanley Ruttenberg, director of research, American Federation of Labor-Congress of Industrial Organizations.

Representative MILLS. Mr. Ruttenberg, we are pleased to have you with us this morning and you are recognized.

Mr. RUTTENBERG. Thank you, Mr. Chairman.

STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR OF RESEARCH, AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. RUTTENBERG. America's tax structure needs immediate revision to foster steady economic growth. Congress can contribute to the promotion of full employment and steady economic growth by reversing the unfair trend of recent tax revisions, which have consistently turned away from the fundamental concept of taxation according to ability to pay. Long overdue adjustments should reestablish the democratic basis of our progressive tax system and reinforce the fair and equitable principle of taxing those who can afford to pay. For too long, repairs in the tax structure have been haphazard provisions, a patchwork of special privileges for higher income groups. Justice now requires changes to spread the tax load more equitably by relieving some of the burden on low- and middle-income taxpayers. To achieve this goal, a first step should be to increase personal individual income-tax exemptions from $600 to $700.

Federal revenue requirements offer no excuse for delaying these changes, because tax revisions need not cause a reduction in overall revenue receipts. Programs in the fields of labor, health, welfare, schools, education, foreign aid and military defense continue to require large expenditures. The need for revenue to pay these mounting costs is clear to all. But the burden of meeting this need should be borne by those best equipped to pay the price. With fair readjustment of revenue provisions, tax changes at this time would not cause an overall loss in revenue. If, however, the Government's budget is reduced by $3 billion to $5 billion, tax cuts as well as revisions should be enacted. If these reductions become possible they should also reinforce the foundation of our tax structure by insuring equity for all in carrying the tax load of our Nation.

To reestablish equity and maintain a balanced budget, some recent revenue changes or some longstanding loopholes would have to be eliminated. Direct alterations in the tax structure—such as dividend credits, extension of capital gains provisions, enlarged scope of depletion allowances, changes in depreciation provisions—have made the tax system more and more regressive in recent years. Other changes—such as tax provisions for family partnerships, stock options, exemptions for interest on State and local government bonds, plus many indirect changes—have created further benefits for higher income taxpayers.

These exclusions, exemptions and loopholes have created another pressing problem—the large amount of unreported income that completely escapes taxation. A recent study presented in November 1955 to the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, showed that 14 percent of dividend income, 30 percent of entrepreneurial income and 61 percent of income from interest is not reported on tax forms. This indicates clearly the results of these loophole provisions that have been written into the tax laws.

These special privileges have caused a narrowing of the income base subject to taxation and reduced the receipts of the Federal Government. As a result, pressure is on Congress to make no tax changes at all, using the excuse that the revenue losses would impair budget needs. But to delay readjustments because special privileges for the wealthy have cut revenue receipts is to foster injustice and to hamper the promotion of steady economic growth. To accept this pressure is to follow the fallacious reasoning that necessary and fair reductions would be disastrous because they would require changing some of the unfair provisions continually weakening the progressive structure of our Federal tax system.

Instead of continuing these inequities at the expense of the bulk of America's taxpayers, it is now time for Congress to consider the best way to restore justice and progression in our tax structure. For almost 10 years—since 1948—there has been no change in the level of exemptions for personal individual income taxpayers. The only relief for individual taxpayers during this period was the lopsided boon of the 1954 revenue revisions, which gave over 90 percent of the total tax cuts to upper income groups. The regressive trend was not halted; it was increased. In fact, if this unfair revision had not been made, it would now be possible to raise exemptions by as much as $200 or $300 per person. The injustice of 1954 should not be used as an excuse for maintaining the status quo. It should give added impetus to the Congress to find a way to remove some of the special privileges enacted recently and to raise exemptions immediately. Federal revenue would be cut by about $2.4 billion, an amount easily recaptured by closing some of the many loopholes listed above.

Historical, equitable and economic reasons for raising exemptions rebut the arguments of those who oppose tax cuts at the present time. Congress should give serious consideration to each of the following arguments in favor of increasing exemptions:

1. Historically, the purpose of exemptions was to permit every citizen to retain enough of his income to maintain a decent standard of living.
2. Prices and the cost of living have risen; and the real purchasing power value of the exemption level has consequently declined.
3. A $100 increase in exemptions would remove from the tax rolls only taxpayers whose income is obviously insufficient to maintain a decent standard of living.
4. Rising incomes for many millions of Americans have moved them up into income levels that would make them permanent taxpayers. The millions of less fortunate individuals, whose incomes have not risen by comparable amounts, should not bear an unfair burden.
5. The fairest and most equitable way to give the bulk of tax relief to the low- and middle-income individuals is by raising individual income tax exemptions.

1. History of exemptions: The reason for including exemptions in the first constitutional income tax law was clearly stated on the floor of the House in May 1913, when a Congressman declared that an income tax "ought to leave free and untaxed as part of the income of every American citizen a sufficient amount to rear and support his family according to the American standard and to educate his children in the best manner which the educational system of the country affords." The same theme was reiterated in August of that same year, when a Congressman stated that individual income taxes required that an adequate standard of living should be exempt and that "a sum below that ought not to be taxed."

Even before the 16th amendment was adopted and the income tax was declared constitutional, the two prior legislative enactments of income taxes made certain that exemption levels were based on a decent standard of living. During the Civil War, our first income tax law was passed. In 1866, commenting in his annual report upon a $600 level of personal exemption provided under the 1864 law, the Commissioner of Internal Revenue said:

It was of course, the purpose of the law, to exempt so much of one's income as was demanded by his actual necessities * * * In other words, the tax principle or policy which was originally adopted to apply to this problem was one of exempting the amount necessary to enable the individual to provide himself with what were considered to be the absolute necessities.

In 1894, another individual income tax was enacted, providing for $4,000 level of exemptions. Although this law was later declared unconstitutional, exemptions were an essential part of this second legislative attempt to provide an income tax as a source of Federal revenue. Finally, when the 16th amendment to the Constitution was adopted, the Congress in 1913 enacted a modern individual income tax law, which provided for a $4,000 exemption for a family of 4. Table I shows the change in exemption levels since 1913.

2. Price rises reduce purchasing power of exemptions: Since 1913, when the first constitutional income tax law was enacted, the cost of living has almost tripled. This means that if Congress were to reestablish the exemption level of 1913, a family of 4 would have exemptions worth almost $10,500 in 1957 prices. Obviously no one is proposing this change. However, the present exemption level for a family of 4—$2,400—does not even approximate the exemption level of the 1930's, which would be worth $6,667 in today's prices. As World War II developed, the purchasing power of the level of exemptions declined because of the sacrifices required to meet the cost of war and to prevent a wartime inflation. At the end of the war, exemptions for a family of 4 were $2,000, which would have bought $2,800 worth of goods and services in current prices. In 1948, the last time exemptions were changed, the level was raised to $2,400, which would be worth $2,600 in 1957 prices.

An increase of $100 per person or $400 for a family of 4 would therefore restore only the purchasing power value of exemptions that existed in the years 1944 to 1947. These suggested exemption levels would not even approximate prewar purchasing power.

3. Taxpayers removed from income tax rolls have earnings below minimum needed for an adequate standard of living: The main arguments against increasing exemptions are that (*a*) too many taxpayers would be removed from the tax rolls and (*b*) every citizen must feel that he is part of the Government and therefore should pay some, if only token, taxes.

Proponents of these arguments do not often describe the earning levels of those taxpayers who would be relieved from paying income—and I emphasize the word "income"—taxes by raising exemptions. Raising exemptions to $700 per person or $2,800 for a family of 4 would drop from Federal income tax rolls those families of 4 whose gross income is $3,100 or less. Can anyone argue that this type of family has an income sufficient to maintain even a subsistence standard of living? A man with an income of $3,100, needs every cent of his earnings to buy the barest necessities of life for his family. Nothing should be drained off by income taxes. Based on Labor Department estimates, which we have updated for current price levels, the minimum decent standard of living for a family of 4 requires a gross income of $4,472 in the year 1957 in America.

Nor is it true that these 4.3 million taxpayers would no longer pay taxes if they were relieved of responsibility for paying income taxes to the Federal Government. In his paper on Federal Tax Policy for Economic Growth, prepared for the Subcommittee on Tax Policy of the Joint Committee on the Economic Report a year and a half ago. Prof. Richard Musgrave shows that families earning between $2,000 and $4,000 per year use 10 percent of their incomes for State and local taxes, and an additional 4 percent for Federal excise taxes. Surely families who pay 14 percent of their already meager income to Federal, State and local governments are fully aware—I might say, painfully aware—of the role of government and its costs.

Those who worry about removing these millions from the tax rolls also neglect to mention the fact that proposed tax changes in the richest country in the world still require millions of American citizens whose earnings are below the standard judged adequate for decent living to continue to pay Federal income taxes.

4. Incomes are rising: American family income has risen substantially in the last decade. Prof. Theodore Andersen of Dartmouth College, in his paper before the Joint Committee on the Economic Report pointed out that—

> the number of families in the higher brackets will be rising in the years ahead, while the number in the lower brackets will be lessening * * *.

He also stated:

> Since 1946, the number of spending units making $5,000 or more annually has risen from 5 million to 19 million today, in 1955. In the same period, the number with incomes of less than $5,000 has decreased from 41 million to 36 million.

Presumably this trend will continue.

These figures indicate that the number of taxpayers who would be relieved of income-tax payments because of increased exemptions would decrease, and that present estimates would not be accurate for the future. They also point to another argument for equity: Surely one cannot maintain that as American incomes rise, the least fortunate citizens, whose incomes have not kept pace, should continue to bear part of the tax burden because of anachronistic exemption levels. Such an argument is entirely inconsistent with the basic principle of our progressive tax structure—taxation based on ability to pay.

5. The fairest method of granting tax relief is to raise exemptions: As I have already indicated, the initial step of raising exemptions from $600 to $700 would begin to reverse the direction of recent tax revisions in the most equitable way. In addition to the arguments already stated, it is important to emphasize the overall fairness of this recommendation: By raising exemptions, Congress would give every American—not just the high-income or just the low-income taxpayers—a tax cut. Furthermore, the distribution of the tax relief would be concentrated among those who need it most—the low- and middle-income taxpayers. The revenue changes would give to the taxpayers

whose earnings are lowest the greatest proportion of the total tax benefit. This type of distribution would thus begin to compensate for the inequity of recent tax revisions, which have consistently favored the wealthy.

CONCLUSION

The justice of the proposal for raising exemptions is an essential consideration for those who wish to promote steady economic growth, because the economy of a democratic society should not have an inequitable tax system. But the economic argument for raising exemptions is equally compelling. Lower taxes for the mass of Americans through increased exemptions is one way of raising the income available for spending. The low- and middle-income groups are those who will use tax relief for purchasing the products of our industries. This spending will create demand for more products and, in turn, create job opportunities that will help to foster steady economic growth. While increasing consumption spending for the steady growth of America's economy, the Congress can see to it that the budget is not jeopardized. The Congress can close tax loopholes, end unreasonable exclusions of income from taxes, and stop the erosion of the tax base caused by such provisions as capital gains taxes, depletion allowances, stock options, family partnerships, et cetera. Closing loopholes—both legal and otherwise—leaves much room for offsetting the revenue lost by raising exemptions and thereby cutting taxes for all Americans.

I shall not discuss here the argument which always arises concerning the value of capital versus consumption expenditures for promoting steady economic growth. I should like, only, to refer you to my statement before the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, in December 1955, entitled "The Declining Role of Business Investment in a Growing Economy."

This statement develops the theme that the growing productivity of capital—the rising output from capital equipment—requires less emphasis upon increasing capital expenditures and more emphasis on increasing consumer expenditures. Stimulation of consumer income, through tax revisions—preferably through increased exemptions—will best promote steady economic growth.

(The tables accompanying Mr. Ruttenberg's statement follow:)

TABLE I.—*Individual income tax exemptions*

Year	Exemptions for family of 4	In 1957 prices	Year	Exemptions for family fo 4	In 1957 prices
1913–17	$4,000	$10,336	1942–43	$1,900	$3,140
1917–20	2,400	4,099	1944–47	2,000	2,869
1921–25	3,300	5,314	1948–54	2,400	2,623
1926–31	4,300	7,084	1955	2,400	2,490
1932–39	3,300	6,667	1956	2,400	2,454
1940	2,800	5,556	1957	2,400	2,400
1941	2,300	4,348			

TABLE II.—*Consumer price index*

Year	1947-49=100	1957=100 (average 4 months)	Year	1947-49=100	1957=100 (average 4 months)
1913-17	46.0	38.7	1942-43	71.9	60.5
1917-20	69.7	58.7	1944-47	82.8	69.7
1921-25	73.8	62.1	1948-54	108.7	91.5
1926-31	72.1	60.7	1955	114.5	96.4
1932-39	58.8	49.5	1956	116.2	97.8
1940	59.9	50.4	1957, 4 months	118.8	100.0
1941	62.9	52.9			

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Representative MILLS. Gentlemen, we thank you for your statements.

The Chair feels if it is agreeable with other members of the subcommittee that, since there are 4 of us present this morning, perhaps we should limit our interrogation to 10 minutes each in order that all members may have an opportunity on the first round at least of interrogating the members of the panel. Is there objection to that arrangement?

The Chair hears none.

The Chair recognizes Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I was in hopes that perhaps the panel members might be induced to cross-examine one another. For example, I would like to see Mr. Collado and Mr. Ruttenberg discuss this question of depletion allowance particularly on foreign production.

I would like to know, Mr. Collado, why the Government of the United States should not make depletion allowances to cut the tax revenue from capital invested abroad when the argument for depletion allowances is basically an incentive to induce the production of oil and other minerals where the production is very difficult.

The argument of the United States has always been, as in the case of petroleum, that since in this country, because of the advanced technology of the United States, the geographical area of this Nation has been tested for all shallow resources and now, to get petroleum, we must sink our wells at great expense to the lower horizons, whereas in the Middle East and in other areas where Jersey Standard operates the development is much more recent and it is much easier to obtain the producing sands, therefore the incentive of depletion allowance does not seem to be necessary.

These are points of view on which both of you gentlemen have expressed contrary opinions, and I think it would be helpful, Mr. Chairman, if we could induce these two gentleman to have at it.

Representative MILLS. Very well.

Mr. RUTTENBERG. Mr. Collado, I would be happy to supplement Senator O'Mahoney's comments with 2 or 3 general statements on which I would like to hear your comments.

One, it seems to me that depletion allowances—whether on foreign developments or on domestic developments—permit a recapture of funds substantially beyond anything ever anticipated in terms of the investment.

In other words, the 27½ percent on oil and gas continues forever, even though you have recaptured your original investment.

Secondly, the tax laws now provide for exploration and development costs to be deducted over and above depletion allowances. It is exploration and development costs, which allow for recapture of the original investment, which is basic and important.

I can see no justification for the continuance of high levels of depletion allowances in the face of the fact that the original exploration and development costs are permitted to be recaptured up to the amount of the extent to which they are invested.

(Discussion off the record.)

Representative MILLS. We will pass to Senator Goldwater.

Senator GOLDWATER. Mr. Chairman, I would like to just preface this general question with a short statement that it seems that these hearings, like the hearings we held back in 1955, are constantly getting to a relationship between the tax policy and economic stabilization.

Now, I think we have to remember that, if we use that approach, we obscure the fact that the major, if not the principal, inflationary force in the economy today is a system of excessive rates of income tax on both individuals and corporations. I say that because these rates use up potential capital at its very source.

I have three general questions. I do not think I will get time to get to all of them. I would like to ask the entire panel to comment on these questions.

The first one is, do you think that excessive rates of income tax are inherently inflationary, first because they prevent accumulation of new capital in the hands of individuals and businesses, and second, thus forces excessive reliance on bank credit as a means for business expansion?

Anybody can sound off on that.

Mr. MUSGRAVE. Senator Goldwater, generally speaking my answer is "No." I can imagine circumstances under which high income tax rates would be inflationary. The situation I have in mind mostly is one of accelerated depreciation combined with expectation that in the near future tax rates are going to be reduced, which would result in investment being moved up.

The long-run aspect of the matter which you have in mind, I take it, is that, since taxes are high, capital formation will be less, and capacity will be less than it would be otherwise. Therefore, less will be forthcoming on the supply side if you have the same demand you will have more inflation than you otherwise would have.

I think that we would first have to ask the question, then, would a reduction in income taxes and corporate taxes go primarily to raise capital formation, or would it also go to raise consumption? On which side would the effect be?

Senator GOLDWATER. My personal feeling on that is that the more capital funds that we have, the more consumption funds we have. One follows the other, and I think what we are finding today is too much reliance upon Government financing or credit financing to provide consumption financing which will never provide sufficient capital financing.

Mr. MUSGRAVE. I would not be too much concerned with whether investment expenditures are being financed out of income which the corporations keep because taxes are reduced or whether they are being financed out of additional credit. It seems to me that the main point is what is the level of investment expenditures.

Senator GOLDWATER. Can you determine, or is there such a thing as a proper level of capital expenditures? Has it not been true that our economy through the years has increased the most when capital expenditures were the highest?

Mr. MUSGRAVE. There is no question but that if over a period of years capital expenditures are higher that your capacity will grow faster and, if at the same time you maintain full utilization of resources, that your income will grow faster.

Senator GOLDWATER. Should it not follow, then, that reduced taxes across the board would produce that desired effect more constantly in this country than relying on credit which, in turn, creates a tightness in the money market which we are going through today through the actual physical lack of money? Would it not be more desirable to reduce these taxes?

Mr. MUSGRAVE. If you were to reduce taxes you would have to tighten credit. In other words, having taxes is a substitute for having credit restriction. The less taxes you have, the more credit restriction you need.

You might well argue that a system of inflation control which relies heavily on credit restriction will give you less capital formation than one which relies more on tax restriction. But certainly, if taxes were to be reduced today we would have to have more credit restriction.

Mr. TERBORGH. You are implying that the tax reduction occurs with no parallel reduction of Government spending, but if you had parallel reduction in both, the question might generate a different answer.

Senator GOLDWATER. I would assume that anybody suggesting a tax reduction would naturally assume a reduction in Government expenditures. In other words, we get away from relying on Federal expenditures for the priming of our capital market.

That seems to me to be the most economically sound thing that could be done in the country today. If we want to promote industrial advancement and consumption, or whatever you want to assign as an important part of the question, to my mind the less the Government spends within reason, producing lower taxes will produce the most ideal economic conditions in the country.

Mr. MUSGRAVE. You really define your answer by saying "within reason." Where does the reason lie?

Senator GOLDWATER. Take into consideration defense, which I think is the most important part.

Mr. MUSGRAVE. Let me pose this question: What expenditure could be a more productive capital expenditure than expenditures on education?

Representative CURTIS. By the Federal Government?

Mr. MUSGRAVE. As far as all levels of government go.

Senator GOLDWATER. If by the local governments, I would agree, but not by the Federal Government. You are getting to another field.

Mr. TERBORGH. Are there not two questions: The effect of the heavy tax rates on the long-run growth capacity of the economy—and I take it there would not be much argument that they are a drag on economic expansion. The second question is whether these same heavy tax rates, assuming a balanced Federal budget, exert an inflationary pressure on the economy.

I should say the answer to that depends on your theory as to the relative impact of these tax rates on the amount of capital accumulation, on the one hand, and the effect on the incentive to invest, on the other.

If they had a more adverse effect on capital accumulation than on the incentive to invest, we would have a shortage of savings, such as I believe we have at the moment, and there would be gerat pressure on the banking system to provide bank credit to make up the deficiency.

That would generate an inflationary expansion of the monetary system unless the central bank restrained it; but at any rate would produce tight credit conditions. On the other hand, it is conceivable that, if this present tax structure had a more adverse effect on the incentive to invest than it had on the amount of investment capital available, it could have the opposite effect. All that is consistent with the proposition that, as a long-run matter, the tax rates are adverse to the rate of economic advance.

Mr. RUTTENBERG. Mr. Chairman, may I inject a word here, because both Senator Goldwater and Mr. Terborgh have used the phrase "very heavy tax rates which exist." I think, as 1 or 2 of the other members of the panel have pointed out in their statements, the effective rates of taxes are considerably different from the actual rates on the books. If we look at the report of Statistics of Income for 1953, in that year when the top tax rate was 92 percent on all income above $200,000 for single and $400,000 for married taxpayers, the individual at the $100,000-a-year level should have paid 67 percent in taxes, if he had followed the straight deductions and exemptions permitted under the law. However, the effective rate that he actually paid was only 45 percent. Furthermore, those individuals with incomes above $5 million, the very top people whom you would expect to be really hit by the 92-percent top rate, paid an average rate of 48 percent. Therefore, the top rates on the statute books are not the effective rates applied against income. I, therefore, cannot see how they are interfering in any way with the amount of money available.

Senator GOLDWATER. Mr. Ruttenberg, I think you are talking in numbers about a very, very small segment of our taxpaying group. If I am not wrongly informed, I believe that over 80 percent of our income taxes come from people who earn less than $8,000 a year. I agree that that is the great group with which we ought to be concerned.

I am told reliably that, if we confiscated all incomes above that, we could run this Government for about 2 or 3 weeks, so that, instead of picking away at what you seem to feel are inequities in a man making $100,000 or $5 million, I think any of us could get along on that sum if they took 98 percent of it.

Mr. RUTTENBERG. Your question was using the term "the very high tax rates that exist," and whether it would not be wise to reduce these tax rates in order to encourage investment and expansion.

Senator GOLDWATER. Do you not call 45 percent a high tax rate?

Mr. RUTTENBERG. Certainly not on these income levels.

Senator GOLDWATER. Do you call 30 percent a high tax rate?

Mr. RUTTENBERG. Certainly not on these levels.

Senator GOLDWATER. How many free republics have existed very long on a tax rate over 25 percent?

Mr. RUTTENBERG. You are talking about a totally different concept.

Senator GOLDWATER. No, no.

Mr. RUTTENBERG. I think you are confusing tax rates with the amount of total revenue as a proportion of the total capital or product of the country.

Senator GOLDWATER. Any way you want to state it.

Mr. RUTTENBERG. You are speaking of the use by some economists of the figure, 25 percent, as the total amount of revenue which they think ought to be collected by all levels of government as a percent of the total product of the country, not about tax rates on income.

Senator GOLDWATER. Your way or my way of expressing it still gets to the fact that I will stand behind my statement that income-tax rates, corporate rates, in this country are excessively high and do not promote economic growth. In fact, they restrict economic growth, and that is what we are here to discuss.

Mr. RUTTENBERG. I think we ought to keep in mind that the top rates of 80 and 90 percent are not the rates paid by the people in those brackets. We, then, ought to use that fact as a frame of reference in terms of discussing whether or not high rates affect investment opportunities.

Mr. TERBORGH. Would it be conceivable that we would get more revenue out of those large incomes by reducing the rates? I understand that the total revenue yield above the 50-percent bracket is less than $1 billion a year because of the dodges that the large incomes have to resort to in order to get out from under the 80- to 90-percent brackets. Is it not conceivable that a reasonable progression in those upper ranges would produce more revenue than the present system?

Senator GOLDWATER. I am convinced that it would. I think the tax reduction of 1954 totaled $7.4 billion. It is interesting to note that tax collections since that time have almost made up that sum. I feel, personally, that if they had been $10 billion we would have been that much better off because we would have increased our capital investments.

For instance, the rate of building increased after those reductions of 1954 to an alltime high, and they are just now beginning to bend downward because, I feel, mostly the lack of incentive.

Senator O'MAHONEY. I was going to point out that, in response to your question, Mr. Terborgh referred to a shortage of savings. You made the comment, Senator, that you have been advised that 80 percent of the tax revenue of the country comes from incomes of less than $8,000 a year. I wonder what Mr. Terborgh would care to say about it, because of the shortage of savings.

Mr. TERBORGH. Well, it is a relative shortage. As you know, Senator, we are under terrific pressure for investment these days. Last year was a phenomenal year.

Senator O'MAHONEY. That is, capital investment.

Mr. TERBORGH. I expected this year to be softer, but it looks solid at this moment. Even 1958, as it looms up in the distance, appears to be a very high investment year and it is in relation to this extremely heavy rate of requirements that I spoke.

Senator O'MAHONEY. That being so, there is a terrific pressure for capital investment and, of course, there has been expansion of capital investment.

Mr. TERBORGH. That is right.

Senator O'MAHONEY. It follows, does it not, that the present rate of taxation is not an impediment?

Mr. TERBORGH. Well, I would interpret it this way: The present structure has less of an impeding effect on investment incentive under present conditions than it has on the supply of investment funds.

In other words, it erodes the supply of investment funds more than it deters or reduces the incentive to invest. It is under this structure, given the vigorous technological revolution that is going on, that a disbalance has developed which looks quite serious and long continued.

Senator O'MAHONEY. There is an evident attempt both upon the part of savings institutions and upon the part of the Government to stimulate savings by people of low incomes. The payroll tax reductions and the increased rate of interest on savings bonds by the Congress, the increasing rate of interest offered by savings and loan associations all emphasize that the shortage of savings in the lower group, do they not?

Mr. TERBORGH. It would be nice if we could get more savings out of the lower group, but it has always been true that the bulk has come from the middle and upper brackets. The top 10 percent of the income scale will account for practically all of the net saving that is done by individuals, 80 percent or better.

Mr. RUDICK. Is it not true that today institutions supply the investment funds rather than individuals, and the reason individuals cannot do it is because the tax rates, particularly in the middle and upper brackets, are so high that they cannot accumulate the capital?

Mr. TERBORGH. The effects of these high surtaxes have been partially offset by the savings of new institutions such as private pension funds which now have a net addition of $2 billion a year. But we are caught with an apparent shortage, which I believe is real.

Senator GOLDWATER. Let me ask a question of Mr. Rudick in that respect. As these tax-free funds grow, and, for instance, we see in labor welfare funds today a total of something around $35 billion to $40 billion, and can look forward in the next 10 or 15 years to that being greater than the amount in the Federal Treasury for old-age assistance and so forth, is it not going to be true that we could reach a point where almost all capital money would come out of these tax-free funds?

Mr. RUDICK. The bulk of it; yes.

Senator GOLDWATER. Are we not just beginning to see today the problems, if you want to call them problems, caused by tax-free funds getting into the money market?

Mr. RUDICK. Yes, I agree. I think if you look at the statistics you will find that each year the percentage of private investment as compared to institutional investment has gone down.

Representative MILLS. Senator, I think we are back on Senator O'Mahoney's time.

Senator GOLDWATER. I apologize. I have gone over the time.

Senator O'MAHONEY. I want this discussion to proceed.

Mr. COLLADO. Senator, the question by Mr. Ruttenberg is directed more broadly to depletion allowance generally. Your questions were limited to the foreign application. I do not think that I would like to make any attempt to get into a discussion of the operating details of the subject, but rather I shall discuss the subject briefly and broadly.

I think that the importance to the national economy and the national security of a healthy oil industry is acknowledged by all.

It has been generally agreed that it was the intent of the Congress, supported by the studies and reports of experts and other groups, in order to induce a considerable measure of investment in the search for oil, to give the return on successful investment at least some differential treatment. Instead of deducting actual exploration and other depletable expenses—but not in addition to deducting them—companies were allowed deductions calculated as a percentage of gross income.

The result has been to induce more capital to flow into that kind of a risky endeavor than might have gone into it under other circumstances. One of the concomitant results has been that, as individual oil ventures have been successful, more people have been induced to search for oil.

The search for oil, certainly in the United States, is not one that requires a heavy investment, and many small as well as large people have gone into it, and studies made by the first National City Bank and others have shown that the actual returns on investment in the oil industry over quite a number of years is slightly less, rather than greater, than the average of other industries.

It takes in the whole variety of people. I am talking about an entire industry. I think that also it is only fair to add that this is an industry whose products bear a total of taxation in all forms that is a very substantial one. It is one of the most heavily taxed products of any by the time it gets to the consumer. I think that could be demonstrated.

I think the resources that have gone into this industry have been induced through some incentive in the taxation field and that has possibly to some extent overcome the disincentives which the product has had to bear in relation to other products in the national economy.

Senator O'MAHONEY. The oil gusher is a great magnet.

Mr. COLLADO. It is a glamorous kind of business and attracts people perhaps beyond the simple financial aspect.

Senator GOLDWATER. Would you give us a figure of what a gallon of gasoline would cost if the total taxes were cut in half?

Mr. COLLADO. Do you mean all taxes on it?

Mr. MUSGRAVE. On the assumption that it would be reflected in price reduction.

Mr. COLLADO. I would rather put in the figure than try to answer it.

(The following supplementary information was supplied by Mr. Emilio G. Collado:)

In answer to Senator Goldwater's question, it can be estimated that a gallon of gasoline would cost in the Eastern United States about 5 cents less if the total relevant taxes were cut in half.

It is not possible to take into consideration all taxes relating to the gallon of gasoline. In 1952 the American Petroleum Institute compiled a partial list of 225 different relevant taxes. It has been possible to estimate, however, that State and Federal excise taxes average about $0.0882 per gallon and that there is a total of $0.0954 a gallon in income, excise, severance, real and personal property, social security, franchise and license taxes. This total amounts to about 47 percent of the price, excluding taxes, of our standard brand of gasoline.

Mr. RUTTENBERG. I thought you were going to say that it would be difficult to make the assumption that it would be passed on to the consumer.

Mr. COLLADO. I don't think that would be difficult to assume. The price reductions are supposed to benefit consumers. One of the advantages of economic growth is to produce more at less cost and to pass the benefits to the consumers.

Mr. RUTTENBERG. That is why we had a price rise in gasoline in January, at the time when we had the heaviest oil inventory that the country has seen.

Mr. COLLADO. I have not really answered the questions. I would like to answer them instead of being led down some bypath.

I think the results have been very good. We wanted, for reasons of national security of all sorts, not security in the present definition that we all think of, but in broader kinds of security, to have a large and sufficient oil reserve available to us in places where it would do us the most good.

We have had it in this country. It is the conscious policy to have it in this country. It served us very well in World War II. It also served us very well in World War II to have production available in other parts of the world where it served our Armed Forces and transport requirements.

The oil reserves served us very well in the Suez crisis when the existence of flexibility in the industry, which was to considerable measure induced by these tax and other factors, made it possible to do a job of maintaining supplies in Europe that I think was a remarkably good one and certainly was so regarded by the recipients of the oil.

Getting from the general to the more specific on the foreign side, I would not like to try to explain in detail the security considerations in the foreign field. I am not a military expert and these are questions which change from time to time. Nevertheless, it seems pretty clear to me that we have a global interest in security and we certainly have a global interest in economic development of foreign countries.

That has been expressed in so many ways that I do not think there is any question. Now, incidentally, I might say that if there were enacted some of the provisions that we have suggested in the past here and in other forms, provisions which the President has suggested in his proposed legislation to extend the 38 percent Western Hemisphere Trade Corporation tax rate, then this question that you have raised, Senator, would not be applicable because under the circumstances the depletion allowance would not be a matter of important concern for Middle East production.

However, I would like to say that the search for oil abroad is not something that lacks the risk elements that are associated with it in this country. I could go on at some length but I will not. The number of countries in which we have had very extensive geological parties out, drilled dry holes and finally abandoned them with finally no results whatever shows that the foreign production of oil is not a uniformly wonderfully attractive thing.

I would like to refer generally to the fact that I do not really think that changing this provision with respect to depletion abroad would in any way enhance the revenues of the United States.

Under the tax arrangements as they now exist at home and abroad, some foreign government, as I said in my paper, would find ways of insuring that the increased costs to the companies went into the public coffers in the producing areas rather than to the United States Government.

Finally, I do think that it is important that some part of the oil abroad be in the hands of American companies and not all of it be left to development by companies of other nationalities and control. Clearly, if we were to make the type of change in the tax system which is implicit in these questions, we would be able to demonstrate very easily—and I have some tables made up at the suggestion of the chairman for the purpose—to show that foreign companies actually have a better tax break in doing business overseas than American companies.

Anything that would worsen the position of Americans would be worsening them competitively against other investors in this field. Finally, I cannot understand any reason why an American investor who ventures abroad, where obviously the going is subject to a lot more difficulties than in the United States, should be penalized as compared with an investor at home. I think if anything he ought to be given a break when he goes abroad.

Senator O'MAHONEY. That includes Aramco?

Mr. COLLADO. Yes, Aramco.

Representatives MILLS. I think, Senator, that your time is up. Mr. Curtis?

Representative CURTIS. I would like to make a comment on the previous exchange of views on the high rate of taxes. It seems to me that the important feature is not, although it is an important feature, the actual rate that people pay, but the different rates that one may pay. As far as our tax structure is concerned, problems exist because the taxpayers have a series of slots, you might say, that they can get into.

One can get into a zero percent tax slot or a 25 percent or, through a corporate form, a small corporation, 30 percent or 52 percent or, getting back to the individual, 87 percent. The top high rate is what provides the power or the impetus that makes the taxpayer seek these other lower levels in the way he handles his affairs.

Therefore, implicit, I might say, but not stated in Mr. Ruttenberg's paper, is the fact that you do start out with this very high tax rate on the individual, so of course any time you give any relief down the line below an 87 percent level you are going to have tremendous pressures to go out there.

I remember when the 80th Congress gave an additional $100 exemption. I think, Mr. Ruttenberg, you and your group said it was benefiting the rich people, which it was under your theory, because $87 out of each $100 exemption that they had was tax relief for them.

Mr. RUTTENBERG. May I interject and correct the record, because we did not say that in 1948. I did not believe it then and I do not believe it now.

Representative CURTIS. I am glad to hear that, but that was used at the time as an argument and I thought it emanated from your group.

Mr. RUTTENBERG. I would much prefer to see individuals in the high brackets at the 87 percent rate get an $87 tax cut as the result of a $100 increase in exemption and the person at the bottom get 20 percent cuts, rather than to see a change in the tax rate structure which will permit the fellow at the bottom to get $20, but the fellow at the top get $1,027.

Representative CURTIS. But the point I try to emphasize is that, when you start out with a tax structure that has a high of actually 87 percent, any time you grant a relief at a lower level, it can be argued that the rich man gets the primary benefit.

I want to get on to a more basic feature of this question of tax relief by directing your attention to inflation. I have tried to pose the point and I think successfully, that inflation itself is a form of taxation and, therefore, it has to be regarded along with these other methods of taxation.

We have been undergoing a period of inflation for the past 2 or 3 years. Other panels of the previous days have been asked their interpretation of what lies behind this inflation. The answers have been that it does not follow the traditional pattern, although I have raised the question that maybe it does in some respects because part of the traditional pattern is a greater demand than there is supply to meet the demand.

The one place I see where the traditional pattern existing is in capital investment where there seems to be greater demand and need for capital investment than there is supply. If, indeed, that is a feature and an important factor of the inflation that we are presently experiencing, and I know from the April figures that the cost of living is continuing to go up, then I think it becomes important to see whether that, in turn, is created by the high level of Federal expenditures and our tax structure.

I pose that as a starting point to find out if any on the panel either agree or disagree, or what your interpretation might be of this inflationary trend that we are presently in. Maybe you think it is temporary. If it is only a temporary situation, I would be interested in knowing why you think that, with particular reference, I again say, to the factor that we are discussing here as to whether our tax structure has a bearing on it and that inflation itself is a form of taxation, I might say, Mr. Ruttenberg, a form which hits the lowest income group, those who are not even on the income tax rolls, probably the most. It certainly hits the consumer the most.

Mr. RUTTENBERG. Could I comment on that?

Representative CURTIS. Yes, it is to the whole panel.

Mr. RUTTENBERG. I have just a brief comment. I think it ought to be pointed out that in the year 1956 we had approximately a 30 percent rise in expenditures for new plant equipment by American industry over and above the 1955 level. There did not seem to be any shortage of funds to finance that expansion.

As a matter of fact, the funds were available and the expansion took place. The tax structure did not interfere with the availability of those funds.

Representative CURTIS. Might I pause just there? I think you are ignoring some pretty important facts, that there has been created a very tight money market as a result of this expansion and demand for funds and that your small businesses, incidentally, have been pretty well left behind in competing for these funds. Interest rates have gone up and we are showing a real reflection of the fact that, although this was accomplished, you had some attendant results that went along with it.

Mr. RUTTENBERG. I am not so sure that the interest rate responded to the demands for high investment funds, or whether the interest rate increased in response to other factors in terms of Government policy.

Representative CURTIS. I can give you an example of one that did not have anything to do with Government policy, the savings and loans. I happen to be familiar with that industry. Their rates went up simply to get the investment money in. We had to. The Government did not have anything to do with that except insofar as they might have been affecting the entire money market, but certainly the existence in the private economy of competition for investment capital is, I would think, so well known that you would not dispute it.

Mr. RUTTENBERG. But investment funds responded to the demands of the market even with higher interest rates in spite of the tax structure.

Representative CURTIS. I wonder if it has really completely responded. I know many businesses, particularly your small ones, that in fact are selling out or going out of business simply because they have not the investment to finance their growth.

Mr. RUTTENBERG. I think large corporations can get all the capital they want because they can get it from institutional investors, but the small-business man can get capital from one source, from individuals, and unless you leave individuals enough money after paying taxes and living expenses to accumulate capital, you are not going to get individuals going into business.

Mr. MUSGRAVE. The question you pose is really quite related to the one posed by Senator Goldwater.

Representative CURTIS. Yes, it is.

Mr. MUSGRAVE. If you apply tax policy to cut consumption expenditures, or if you cut Government expenditures and then release those resources to go into private investment, you hold total expenditures constant while putting a larger fraction thereof into private investment. This will be an anti-inflationary move because you leave the demand side unchanged, but you increase capacity.

On this point I quite agree. However, this is not the only possible anti-inflationary policy. Instead, we may take measures which cut back all expenditures including private investment, consumption and Government, or whichever combination we want.

There seems an implication in your questions that if you want to check inflation, you have to do it by cutting Government expenditure and permitting more capacity-creating investment. This is one way in which you can do it, but not the only one. Moreover, stimulating private investment is a solution only if at the same time you cut your other expenditures.

Representative CURTIS. May I interject this one thought? But at the same time to allow for growth.

Mr. MUSGRAVE. Yes, exactly. Then you have more growth. Now, on the other hand, just because this solution wil leave you with more growth does not necessarily mean that it is the best solution.

In other words, it seems to me that throughout these panel hearings there has been developing what is almost an obsession with economic growth. It is just like the idea of full employment at 100 percent was in the late 1930's.

We also ought to ask this question: We have different approaches to economic stabilization to choose from. Which is the one which will give us a system that is more stable in the long run? If we now check inflation by accentuating capital formation, will this leave us 5 or 10 years from now with a more stable system?

Moreover, we have to ask the question, what are the implications for income distribution through the tax system and otherwise if we stabilize by running forward into more growth, or if we stabilize by restraining total (including investment) expenditures? Under the proper assumptions more investment is a way to check inflation, but I am not so sure it is the only way or always the best way of doing it.

Representative CURTIS. You used the words "obsession with the idea of growth." I do not regard it as an obsession because I think the factors are that this automation is going on and the need for our economy to continue this advancement in new technology is just with us and we have to recognize that. That impetus is going to continue to force us to more growth at a rapid rate.

Instead of machinery wearing out these days, it is becoming obsolete and obsolescence is the thing. This is just as much a factor in our economy, it seems to me, as anything else we have discussed.

Mr. MUSGRAVE. It is a wonderful thing that we have growth, and one of the reasons why the economy has been so prosperous is that we have this technological upsurge which Mr. Terborgh mentioned.

I only mean to say that it does not follow that in designing public policy in dealing with stabilization we ought always to choose the answer which makes growth even greater and greater.

Representative MILLS. Yesterday, during the hearings, I posed a question to that panel in order to obtain its advice. This is the question to them: Do you see either in the consumption or in the investment sector of private demand any deficiency serious enough to warrant our enacting some form of tax reduction with the risk of adding to inflation?

That panel, I think, was substantially in agreement that we are not now facing any such deficiency and that we should, therefore, defer tax reduction until (1) some reduction in actual Federal spending is achieved; (2) we build up a larger surplus than now is in prospect as a result of economic growth; (3) the economy enters a recession.

Do you gentlemen agree with the proposition? Do you, Mr. Terborgh?

Mr. TERBORGH. Yes.

Representative MILLS. Do you, Mr. Rudick?

Mr. RUDICK. Yes.

Representative MILLS. Mr. Musgrave?

Mr. MUSGRAVE. Yes.

Representative MILLS. Do you, Mr. Costelloe?

Mr. COSTELLOE. Yes.

Representative MILLS. Do you, Professor Seltzer?

Mr. SELTZER. Yes.

Representative MILLS. Do you, Mr. Collado?

Mr. COLLADO. I do in general. I think the dangers of inflation will overweigh what I am going to say, but I do think there is some danger of running into a general extreme tightness of capital funds for investment. Such a situation would have depressing effects on the rate of investment and I do not think that such effects can be ignored.

Representative MILLS. That would not be general tax reduction, however; that would be some form of relief in a limited area.

Mr. Collado. Well, possibly. I just do not want to throw that out as being so secondary to these other considerations that you can ignore it, but I think the inflation issue is more serious than that in general.

Mr. Ruttenberg. I am not in agreement with the proposition. I believe that the economy's rate of growth in the year 1956 and the prospect for the year 1957 has been inadequate. It ought to be more rapid. We ought to be moving along at a rate of growth in excess of the 1½ or 2 percent on real wages in 1956 and on what is anticipated in 1957. On that basis, therefore, I believe that we ought to have tax cuts for the low and middle income people, in the main, where exemption would be concentrated. It might be necessary under these circumstances to raise revenues elsewhere in order to offset that loss.

I think the equity growth in the economy requires that some consumption income be injected at the lower extreme of the ladder.

Representative Mills. Let me clearly understand you, Mr. Ruttenberg. Would you defer the increase in exemptions in the interest of economic stability and in the light of present economic conditions until we actually achieve the offsetting income through the closing of the loopholes you referred to, or would you do it first and then hope that compensating revenues could be obtained from other sources?

Mr. Ruttenberg. I would take the latter course.

Representative Mills. You would take the latter course?

Mr. Ruttenberg. Yes.

Representative Mills. I have some difficulty, frankly, in understanding how we would help the American people by decreasing their tax burden if at the same time we may well increase inflationary pressures reflected in rises in cost of living in such a way as to offset any proposed benefit through tax reduction.

Will you straighten me out on that? Am I wrong on that?

Mr. Ruttenberg. I think we ought to look at some other factors when we consider what is responsible for rising prices. Look at an automobile industry currently operating at a rate considerably below 1955 and up and down from its 1956 levels; at a steel industry now getting down into the mid 80s and probably will drop to the mid 70s as a percent of capacity in July and August; at a time in the economy when new housing starts are now for the first time in the last 5 or 6 years operating at an annual rate below a million.

I think the cost-of-living rise comes not from an overdemand in relation to supply, but from some other factors.

Representative Mills. Like you, other Members of Congress, and the panel, I, of course, am interested in doing whatever we can through Government policy to promote economic growth, but I have never thought that we were being quite fair when we take credit for economic growth which is not real growth, but growth obtained at the expense of inflation because of lack of correct Government policies; nor do I feel that the people themselves in the long run will prosper as a result of growth which is predicated largely upon inflation.

I am fearful that, if we do not proceed with caution, therefore, with respect to fiscal policy, we may well generate more growth based upon inflation and not upon real terms, and that in the long run may not serve the objectives of the Employment Act or the objectives which the Congress or you in your great organization or any other organization may actually desire.

Therefore, I thought that perhaps we could all agree that we would not reduce total revenues to the Government if in the process of reducing those total revenues to Government we do run the risk of increasing inflationary pressures, that we postpone such reductions until we could arrive at one of these three points that the panel of yesterday suggested might be appropriate.

Mr. RUTTENBERG. Let me just implement my own position, because I am in agreement with the way you stated the proposition the last time, but it is different from the way you stated it at first.

Are we for reductions in total tax revenue?

Representative MILLS. I did not intend it to be different. I asked you specifically if you could do this ahead of the time that you had achieved compensating offsetting revenues.

Mr. RUTTENBERG. I am against a reduction now in tax revenue. I am not against a tax cut designed to reestablish some equity within the economy.

Now, you put the proposition to me: What if you cannot raise compensating revenue, then what would you do. My response to you was that I would still raise exemptions by cutting taxes because I think, and I say this as an economist who has looked at the tax picture for a good many years, that the Congress has gotten itself into the box where it makes one revision after another for the higher-middle and upper income levels and is never able to grant the reduction necessary at the bottom. It is about time that Congress did something about the box it has built for itself.

Therefore, as for the excuse that we cannot cut taxes now because we need revenue, we obviously need the revenue. But the revenue we are drawing now results from the kind of tax changes which have occurred in the past 10 years in both the Democratic and Republican Congresses. I think the pressures which have brought about the kind of tax revisions, family partnerships, stock options, dividend benefits, and so forth, have made it impossible for the Congress to reduce taxes where they ought to be reduced, which is in the lower middle brackets.

Representative MILLS. What you are seeking is tax revision so that the burden of taxation will be somewhat shifted but overall revenues will not be reduced.

Mr. RUTTENBERG. My position is clear. I am against the reduction in tax revenues. I am not against a tax cut in the right places.

Representatives MILLS. Well, you agree, then, with my summation of your position that what you really are seeking is revision and a shifting, within the framework of existing revenues, of the various elements of the tax.

Mr. RUTTENBERG. As I said in my statement, until we can get a $3 billion or $5 billion reduction in Government expenditures, I would not move to a tax cut that is not compensated by increased revenues.

Representative MILLS. But you would not suggest to the Congress that in the course of the fiscal year 1958, on the basis of the facts we now can foresee are likely to exist during that period of time, that we take such action with respect to fiscal policy as to result in deficit financing in the fiscal year 1958?

Mr. RUTTENBERG. Well, you put the reverse situation back to me and I want to make it perfectly clear that I think the Congress has the responsibility not to just say because revenues are needed and a balanced budget is needed that we should do nothing taxwise. I think this is the wrong attitude in my judgment for the Congress to take in 1958.

Representative MILLS. Can we, then, members of the panel, proceed to formulate tax policy that includes deficit financing in 1958 and contend that we have responsible fiscal policy?

Mr. TERBORGH. No.

Representative MILLS. Mr. Terborgh, you say "No." Mr. Rudick?

Mr. RUDICK. No.

Representative MILLS. Mr. Musgrave?

Mr. MUSGRAVE. No.

Representative MILLS. Mr. Costelloe?

Mr. COSTELLOE. I could not call the Congress irresponsible.

Representative MILLS. I do not say that. Could we say that we had performed a responsible act?

Mr. COSTELLOE. No.

Representative MILLS. Mr. Seltzer?

Mr. SELTZER. On what we could see right now, no.

Representative MILLS. Mr. Collado?

Mr. COLLADO. No.

Representative MILLS. Would you agree that we could not say we had created responsible fiscal policy under those circumstances?

Mr. COLLADO. In fiscal 1958, as I look at it, we ought to have a budget which is in balance. I repeat this does not mean that we should overlook the necessity now for getting some equity adjustments in the tax structure. By that I mean cutting taxes at the lower level.

Representative MILLS. My time is more than up.

Senator Goldwater.

Senator GOLDWATER. I have no questions.

Representative MILLS. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I am puzzled by statistical and realistic facts which confront the country. Yesterday Assistant Secretary of Defense Mr. Quarles was testifying with respect to defense appropriations, particularly with respect to airpower. I said that unless there is some way of stretching out the expenditures which had been recommended for maintaining airpower the debt limit would have to be increased by $2 billion or $3 billion. The latest issue of Economic Indicators for May 1957, which, of course, is prepared for the Joint Economic Committee by the President's Council of Economic Advisers, shows that the public debt at the end of the fiscal year 1951 was $225.3 billion and that for fiscal 1956 it was for the total year $272.8 billion, but that the cumulative totals for the first 9 months of 1956 and 1957 are running respectively at $276.4 billion and $275.1 billion. In other words, here is an increase in the national debt and one that is likely to be much greater if we keep our airpower as high as it ought to be to meet the Soviet airpower.

Now, on page 4 of the Economic Indicators under the table "Sources of Personal Income," I find that farm proprietors' income in 1951 amounted to $16 billion but it has steadily declined year by year and in 1956 was reported at $11.6 billion. Business and professional income lumped together have increased from $24.8 billion to $29.1 billion. Dividends have increased in the same period from $9.1 billion to $12 billion. Personal interest income has increased from $11.6 billion to $17.4 billion and the nonagricultural personal income has increased from $235.7 billion to $310 billion. At the same time we know that there are disaster areas in the country in which employment is difficult, busines products are difficult, individuals are finding it very had to make any income and at the same time small businesses are clamoring at the door of the President through the Small Business Administration for loans which they cannot get through banking facilities or credit agencies.

Meanwhile, consumer credit is increasing all the way along the line.

Now, does this situation suggest anything to you gentlemen with respect to what our tax policy should be? Is this spotty condition of depression indicative of something that is to happen? Should we take preventive action now and, if so, what; or should we wait until things get considerably worse? Would not the exemptions that Mr. Ruttenberg suggested tend to stabilize this situation before it gets worse?

Senator GOLDWATER. Mr. Chairman, I would like to comment very briefly on that. I think Mr. Ruttenberg suggested $2.4 billion as a result of his suggestion on exemptions; is that correct?

Mr. RUTTENBERG. A $100 change in exemptions would be between $2.4 billion and $2.5 billion.

Senator GOLDWATER. I think that is less than 1 percent of the rate of national income today. I cannot believe that 1 percent added to the total money stream of the country would have any effect such as you would like to achieve, Senator. On the other hand, I think in the answering of the question I would answer it by saying that I think we are just getting caught up with ourselves. I think the Government interference in the agricultural field is the chief trouble with the farmer and the excessive rate of taxation, excessive taxes in this country have produced an unreal increase.

For instance, in the first quarter of this year total disposable income was running about 2½ percent above last year's first quarter, but we had 3 percent inflation. If you want to look at it honestly, we had a half percent less to spend in this country for consumer's needs than we had at this same period last year.

My personal reaction to the Senator's total question is that we are now beginning to pay the piper and we had better change the tune a little bit before the expense gets too heavy.

Senator O'MAHONEY. I anticipated what the Senator from Arizona would say. I am more or less acquainted with his point of view. What I was trying to get was not the opinion of any of my colleagues on this committee but to get the response from the experts who are before us.

Senator GOLDWATER. I could not resist the temptation.

Senator O'MAHONEY. It is always difficult; I know from personal experience.

Representative MILLS. Professor Musgrave.

Mr. MUSGRAVE. Concerning the first two points Senator O'Mahoney raised, with regard to the statement by Assistant Secretary Quarles, I think it would be an absurdity to permit an impairment of our defense requirements by such an archaic institution as the debt limit. The Congress legislates expenditures. The Congress legislates taxes. The Secretary of the Treasury manages the debt. The concept of the debt limitation as an additional legislation by Congress, presumably to check on itself, is without justification. This only highlights this continuous issue of tax burden versus the problem of defense requirements. Senator Goldwater, we may debate what we do about inflation, or how fast the country ought to grow. These are all debatable questions on which mistakes here and there will not make too much difference.

Senator O'MAHONEY. They are making a tremendous difference in the cost of defense items.

Mr. MUSGRAVE. Let me make this point: To argue that the tax burden is so heavy that we cannot meet the requirements of defense, whatever they may be, would, it seems to me, be to make a tragic mistake. Any of the other questions in fiscal policy which we confront today, including the question of equity, including the question of the rate of growth, are just negligible in importance to the fact that we must not make this mistake. It simply is a phantom argument that we cannot bear our defense requirements. It seems to me this is the one thing all Americans ought to be agreed on in talking about this matter of fiscal policy.

Senator O'MAHONEY. We ought to bear them and must bear them, but we must distribute the burden equitably.

Mr. MUSGRAVE. I would hope we would, but I want to make sure we bear them.

Senator O'MAHONEY. Are we bearing them?

Mr. RUTTENBERG. This we have not done, Professor Musgrave, borne the cost of meeting these needs. I agree with you fully that we ought to meet the needs of the military defenses and the foreign-aid requirements of this country. I think we ought to do all of this, but I do not think we have done it on an equitable basis in the revenue system. I do not think Congress can sit back and say longer, "Because we need the defense we ought not to make changes."

Mr. MUSGRAVE. I did not myself like some of the things in the Revenue Act of 1954, but if you take the preceding legislation for tax reduction, the general distribution of the tax relief was reasonable enough.

Representative MILLS. Professor Seltzer.

Mr. SELTZER. The real questions raised by Senator O'Mahoney were, I think, different from those to which replies were made. As I understood, the Senator raised the question whether the spotty adverse conditions we have in different industries portend something more general, for one thing, and asked, secondly, whether we could attack these spotty conditions by general overall fiscal policy.

Senator O'MAHONEY. Right.

Mr. SELTZER. And I presume the answer to the second question is, "Not very well without bringing on the danger of inflationary result."

Senator O'MAHONEY. But we have inflation.

Mr. SELTZER. Well, there is always, more or less.

Senator O'MAHONEY. Admiral Lattu, the head of the Procurement Division of the Department of Defense testified before a Senate Committee only a short time ago that the increase in the price of oil which was announced at the beginning of the European lift would cost the Defense Department $84 million which had not been budgeted at all.

Mr. RUTTENBERG. I dare say much of the increase in armaments comes about as a result of the increase in steel prices. In 1956 the steel-price increase was 3½ times the wage increase.

Senator O'MAHONEY. Secretary of Defense Wilson ascribed the increasing expenditures to increased prices and the President in his television broadcast about his budget said that we must recognize that the price of peace is high and that the price of the things we must buy has increased.

Now, do not these facts enter into the determination of our fiscal policy somewhere along the line? I would like to see you gentlemen in unanimous agreement making your recommendation to Congress. We need the assistance of wise men such as you.

Mr. MUSGRAVE. Well, we have to do all we can, including maintaining taxes to check inflation and the increase in defense expenditures which results from it. I think that is the main answer here. We ought to do this job in a noninflationary fashion.

Senator O'MAHONEY. Can fiscal policy be discussed intelligently without discussing also the need of controlling inflation?

Mr. MUSGRAVE. No; fiscal policy is part of the problem of controlling inflation. Controlling inflation is one of the tasks of fiscal policy.

Senator O'MAHONEY. Has any recommendation been made here about controlling inflation?

Mr. MUSGRAVE. Well, the only question this might raise is whether we ought to recommend an increase in taxes. The chairman has asked the question whether anybody would favor tax reduction next year. Now, then, maybe he could embarrass the panel if he could go down the line and ask everybody, "Well, you do not favor reduction. Do you favor increase and if not why do you think that present rates are just right?"

Representative MILLS. I did not want to ask a theoretical question.

Senator O'MAHONEY. I am advised by the timekeeper that my time will be up at 12:10. It is almost 12:10 now. I think the responses which I have received fit into the statement made by Senator Goldwater that we have caught up with ourselves. I do not use that phrase in the same way that he does. I think we have caught up with ourselves in failing to realize that this defense problem is so great a burden upon all of us. We have forgotten or we have allowed a large segment of the producers of the articles that are needed for defense to continue to think that they can make a big profit out of it.

Representative MILLS. Yes.

Senator GOLDWATER. Mr. Chairman.

Representative MILLS. Senator Goldwater.

Senator GOLDWATER. The Senator referred to me. I would like to set the record clear. I think this country can afford the defense costs that are imposed upon it now but if we continue the way we have been going and the way we are going today, defense costs are going to increase. I do not think anybody will argue that point so that the big question in my mind is how long can this economy of ours remain free and still sustain the increasing loads. Now, I will agree with Mr. Musgrave that there are other sources of inflation than what we are talking of here. I think wage increases at an incorrect time contribute. I think price increases at an incorrect time contribute to it. How we can control those I do not know, but the question overall, the overriding question in the country today in my mind is how long can this economy stay free and not become socialized if we allow it to go at the present rate, and none of us like it.

Senator O'MAHONEY. You state the question better than I can attempt to state it.

Senator GOLDWATER. I am glad you agree with me.

Representative MILLS. Gentlemen, I am sure that all the members of the panel will agree that what we have discussed this morning does not in any way reflect a feeling on the part of the panel that tax revision to eliminate so-called inequities, real or theoretical, should not be at all times undertaken by the Congress. Mr. Ruttenberg has referred to inequities. I have myself in the past referred to some inequities in our tax laws. I wonder, however, if we reduce some of the inequities that exist in our tax law by merely increasing the exemptions from $600 to $700 or if there are other and better ways of eliminating inequities.

Professor Musgrave, would you and Professor Seltzer have any comments? I will get to other members of the panel if you do not.

Mr. MUSGRAVE. Let me just comment on the exemption problem. Suppose we are going to give relief to income-tax payers in the low-income brackets. Which way do we want to do it? I would prefer, as I said in my statement, not to increase exemptions but instead to split the first $2,000 bracket into two $1,000 brackets.

Representative MILLS. You want to get more progression into the system with respect to lower incomes.

Mr. MUSGRAVE. Yes. Since it is my central principle of sound tax policy, that the income tax ought to be the core of the tax system, I would like to keep as many people as possible paying the tax bill through the income tax rather than through excise taxes. I feel that taking the lower and middle income groups out of the income tax will only lead to a Federal sales tax. I would rather have them pay by staying in the income tax.

Mr. RUTTENBERG. It will produce a Federal sales tax if the Congress, and I say that seriously, fails in its responsibility to raise revenues by making the income-tax system more progressive and that is by closing some of these loopholes and erosions that have occurred. If we can reduce it to the first brackets and thereby get equity, I am for that; but my fear is that once you begin to divide the first bracket you are going to get tax-rate changes across the whole line. This is what I oppose.

Mr. SELTZER. I would subscribe to what Professor Musgrave said. I would add that if you just change the exemption level and raise the exemptions you have magnified some difficulties that we now have by reason of the same treatment, the same per capita exemption for single persons who live independently as for two members of a married couple; as for the sixth child, say, in a six-child family. It seems to me that we can handle this problem more definitely with greater justice than by a rather simple but not very discriminating rise in the exemptions. Moreover, a raise in exemptions is very costly. Mr. Ruttenberg said $2.4 billion. My own figure would be nearer $3 billion under present conditions and I think there are other ways of providing relief at the very bottom. One that has occurred to me is to give a $100 earned income deduction to all employed taxpayers.

That would give some relief at far less cost than the per capita exemption increase and would spread the relief, I think, a little more equitably.

Senator O'MAHONEY. Mr. Chairman, may I just make this comment in conclusion?

Representative MILLS. Yes.

Senator O'MAHONEY. On page 8 of the Economic Indicators for May 1957, we find a diagram showing corporate profits, dividend payments, and undistributed profits. Below that we find the figures which explain the graph. Corporate tax liability in 1951 is set down by the Council of Economic Advisers of the President at $22.5 billion; in 1956, $22.1 billion, a reduction of $400 million. The corporate profits after taxes increased from $18.7 billion to $21.7 billion. The dividend payments increased, as I said before in another table, from $9.1 billion to $12 billion. Undistributed profits increased from $9.6 billion to $9.7 billion, an increase of $100 million. There you find that in this unusual economy under which we must live if we are going to carry on defense, the fiscal position of organized business and in the corporate form is improved while that of small business and the farmer is getting worse and worse and disaster areas are growing. That, I think, is something that Congress cannot overlook and it must have the advice of wise gentlemen like you.

Representative MILLS. I am sure there are other questions in the minds of the members of the subcommittee. I had intended to ask Mr. Collado and Mr. Costelloe, particularly with respect to this new British program for treatment of foreign income and its effect upon American investments in a little greater detail than you had stated in your opening papers but there is a quorum call in the House. I am sure Senator O'Mahoney has other matters that will require his attention. Therefore, if there is no objection, we will express to you gentlemen just prior to adjourning, our appreciation of your being here, your great help to us in this study, and express the hope that we may see you at some time in the future under even more favorable circumstances than those in our economy today.

The committee will meet tomorrow at 10 a. m. in this same room. Without objection, the subcommittee stands adjourned until that time.

(Whereupon, at 12:20 a. m., the subcommittee recessed to reconvene at 10 a. m., on Friday, June 7, 1957.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENT

FRIDAY, JUNE 7, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to recess, in room 224, Senate Office Building, Hon. Joseph C. O'Mahoney presiding.

Present: Representative Mills (chairman of the subcommittee) and Senator O'Mahoney.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy; John W. Lehman, acting executive director; and Hamilton D. Gewehr, research assistant.

Senator O'MAHONEY. The chairman left an opening statement for the session this morning, which I shall be glad to read.

The Subcommittee on Fiscal Policy of the Joint Economic Committee today continues its hearings on the fiscal-policy implications of the economic outlook and budget developments. We have been seeking information and advice with respect to current and prospective economic conditions and their bearing on the broad outlines of a responsible fiscal policy.

Everyone, I believe, is agreed about the desirability of tax reduction for the long run. Many people feel that substantial improvements can be made in the Federal tax system from the point of view of equity and its adaptability to the requirements of a dynamic and growing economy. Questions of timing of any such changes to conform with the requirements of economic stabilization, of necessity, must be paramount.

We are fortunate in having with us today representatives of a number of important economic organizations, from whom we hope to obtain some advice on the topics I have just outlined.

Our procedure is to hear the opening statement of each panelist before proceeding with a general discussion.

We will hear first from Mr. Frazar B. Wilde, chairman of the research and policy committee of the Committee for Economic Development. Mr. Wilde, it is a pleasure to have you with us today. You are recognized.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. WILDE. Senator and gentlemen, my name is Frazar B. Wilde, president of Connecticut General Life Insurance Co. and chairman of the research and policy committee of the CED. I appear here today at your invitation to present the views of CED's research and policy committee.

Your committee has been given a statement which represents in condensed form the point of view and recommendations of CED with respect to the present fiscal situation. To conserve your time—we have many valuable papers here—I will not read that paper, but will attempt to summarize it in my own language.

Senator O'MAHONEY. The paper will be set forth in full in the record, Mr. Wilde.

(The document referred to follows:)

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN, RESEARCH AND POLICY COMMITTEE,[1] COMMITTEE FOR ECONOMIC DEVELOPMENT, AND PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE CO.

I am Frazar B. Wilde, president of Connecticut General Life Insurance Co. and chairman of the research and policy committee of the CED. I appear here today at your invitation to present the views of CED's research and policy committee.

We are asked to discuss the current expenditure and tax policy of the Federal Government. Three weeks ago our committee issued a policy statement on this subject, copies of which have been supplied to members of your subcommittee and which I would like to have considered as part of my testimony. I shall not attempt, in the short time at my disposal this morning, to rehearse the arguments and recommendations of that statement. Basically, our position is a simple one:

First, expenditures should be reduced; second, taxes should be reduced as soon as it is clear that this can be done while leaving a moderate cash budget surplus under present economic conditions.

Whether taxes can be reduced in this session of Congress cannot be told until more action has been taken on appropriations and until the effects of those actions upon expenditures have been appraised. We certainly hope that sufficient reduction in authorized expenditures will be made, so that tax reduction on a sound basis will not be delayed.

These recommendations are not based on a forecast that we will or will not have inflation or deflation this year or next. They are not offered as short-term offsets to cyclical fluctuations in the economy. They are advanced as urgent steps in the proper long-run direction, to be taken promptly.

Our recommendations are not addressed to shoring up or restraining particular sectors of our economy that may be particularly weak or particularly booming. In an economy where production is continuously being adapted to the needs of consumers and investors, there are always some industries and areas that are rising and others that are declining. This is not inconsistent with general prosperity, and does not call for remedial action by Government. Attempts by Government to remedy the special problems of particular sectors do not make for a healthy economy. They are more likely to consign a sector of the economy to permanent dependence on a Government crutch.

WHY REDUCE EXPENDITURES?

In popular cartoons, the budget cutter is often pictured as a little, shortsighted, narrowminded man brandishing an ax in a reckless attempt to cut the Government back to the size of 1890. The budget issue is described as an issue between outmoded financial dogmas and modern human and national needs.

For myself and for the CED I want to disclaim this caricature and deny that this is the true issue. In a series of policy statements issued in the past 15

[1] The Committee for Economic Development is a private, nonpolitical organization of businessmen formed to study and report on the problems of achieving and maintaining a high level of employment and production within a free economy. Its research and policy committee issues from time to time statements on national policy containing recommendations for action which, in the committee's judgment, will contribute to maintaining productive employment and a rising standard of living.

years CED has demonstrated its awareness of national needs and government responsibilities in the 20th century. Precisely because we are concerned with the second half of the 20th century we in the CED are alarmed by a trend of rapidly rising Federal expenditure that has gone on through peace and war, through depression, prosperity and inflation, through democratic and Republican administrations. We believe that this trend is dangerous to the efficient, dynamic, decentralized and free society upon which we must rely to meet the needs and aspirations of the American people.

We have in this country a highly effective society for meeting national needs. This society includes the private economy, voluntary associations of all kinds, the existence of needs to say that they should not be met by Federal spending. State and local governments and the Federal Government. It is not a denial of the existence of needs to say that they should not be met by Federal spending. It is a denial that every problem, every need, every felt want is best met by Federal spending. It is a plea for maximum reliance upon the other elements of our society.

There are strong arguments for keeping reliance upon Federal spending to a minimum. Spending decisions will be more economical and efficient if they are made directly by the people who pay the bills. The economy will grow more rapidly if the investment of savings must meet the test of profitability in a competitive market. The freedom of the individual will be more assured the more limited is the size and power of the central government. Last but not least, we can help avoid inflationary pressures by holding down the size of the national budget.

The unfairness with which the burden of Government spending is distributed among the people is not fully recognized. I do not refer here simply to the nominal distribution of taxation, which is bad enough. But the legal imposition of taxes does not determine the final allocation of the burden. Individuals and businesses differ greatly in their ability to escape the burden by passing it on in higher wages and prices. Those with weakest bargaining and market power pay not only their own taxes but also the taxes of others, in the form of reduced real incomes. The inflation we have been experiencing has been partly, in my opinion, a process of passing on the costs of government. This is especially likely to be true when Government programs, like parts of the defense program, are pushed with a speed that is bound to be inflationary.

These arguments obviously do not rule out all Federal expenditure. There are functions that only the Federal Government can perform, and today these are large and expensive functions. But every Federal function and expenditure must be rigorously and critically examined in the light of these strong arguments. This has not been done. Introduction of new programs and expansion of old ones has been accepted as a matter of course, as a remedy for every real or fancied ill. Programs have been adopted without knowledge of their ultimate cost and scale. Various programs have been advanced by the influence of particular groups that have special interests in them. And the whole process of increased spending has been facilitated by the automatic increase in tax revenues from our growing economy, which has permitted larger expenditures to be financed by higher tax rates.

As a practical matter, the way to democratic process functions at the present time, there is no adequate balancing force to the aggressive demands of well-organized groups.

I am not at all impressed by the argument that because our economy is growing we need or should have larger Federal expenditures. This argument is probably valid for some objects of expenditure, such as roads. But it is certainly not true of many other expenditures. In fact, one would expect that as people become more prosperous, the need for many Government expenditures would decline. Rising private incomes and employment opportunities should enable us to spend less on such things as aid to agriculture, housing subsidies, and public assistance. But we don't. We used to be told that the Federal Government had to spend large sums because the private economy was not working well and because people were poor. Now it appears that we must spend even larger sums because the economy is thriving.

In any case, the point is not whether the total Federal expenditures are now a large or smaller proportion of the gross national product than they were in some earlier year. The point is whether all the particular expenditures that are proposed are necessary. We believe that many of them are not.

HOW TO CUT THE BUDGET

Every item in the Federal budget should be tested by six questions:

1. Is there a real need?
2. Must the need be met by Government?
3. Must the need be met by Federal Government?
4. Does Federal spending meet the need?
5. Is the Federal spending program efficient?
6. Must the spending be done now?

In our policy statement we consider a number of major programs and suggest reasons for believing that they do not fully meet these tests. For example, we question whether the mortgage purchase program is meeting a need that must be met by Government. We suggest that Federal grants for public assistance have exceeded the proper responsibilities of the Federal Government. We point to the failure of Federal spending for aid to agriculture to solve the basic farm problem. The agricultural program has been self-defeating because it is too large and it has demonstrated that it fails to meet the practical problems of agriculture in a free society. We question whether our defense program is efficient, either in the sense of the suitability of our plans to our requirements or in the sense of the economy with which the plans are executed. We recommend that some of the proposed public works projects should be deferred or even eliminated.

We do not favor a meat-axe approach to budget cutting. Some functions are vital and should not be cut. Some may need expansion. The meat-axe is an instrument of despair, and only justified if it is impossible to get the information and cooperation needed for a discriminating cut.

Cutting and controlling the budget requires cutting and controlling programs Something can be done, always, by increasing efficiency. But basically we must get at the number and kinds of things the Government does and the scale on which it does them. This is not going to be easy. There is nothing in the budget that somebody doesn't want.

In this connection one of the major changes which the Congress needs to adopt is the item veto. Any program which meets the test of real need is not likely to suffer an item veto and, if it did, it could be passed over the veto.

Fiscal year 1958 will begin in 23 days. It is not realistic to expect that all the program changes necessary to reduce the budget can be made in time to affect the 1958 expenditures. Moreover there are outstanding program commitments, as in the case of farm price supports, that limit the possibility of reductions in 1958.

Nevertheless there are cuts that can be made for 1958, and steps can be taken now that will hold down expenditures in subsequent years. I have attached to this statement a table listing cuts in fiscal year 1958 nondefense cash expenditures amounting to almost $2 billion. These cuts are consistent with the general principles listed by CED in its recent policy statement, but I want to emphasize that the specific suggestions reflect only my personal views. Although the table does not specify reductions in the defense budget, I am confident that economies, possibly of the order of $1 billion, could also be achieved there.

If such cuts were made they would permit enactment of a moderate tax cut to take effect at the beginning of 1958. They would raise the prospective 1958 cash surplus to over $5 billion and would give promise of a continued surplus in later years.

HOW TO REFORM THE TAX SYSTEM

One of the main purposes of budget reduction, of course, is to permit tax reduction and reform. I want to stress the reform part of reduction and reform. All tax reductions are good, but some are much better than others. And some tax reform can be achieved, if the need is sufficiently understood, without overall tax reduction, by reducing some taxes and increasing others.

In our recently issued policy statement we indicated what we considered the most needed steps in Federal tax reform. These include:

1. Reduce high individual income tax rates.
2. Eliminate or reduce special tax treatment now provided for certain kinds of income.

(The special preferences and high individual income tax rates are not only basically immoral and unfair, but they are increasingly contributing to tax immorality and other bad ethical practices.)

3. Integrate corporate and individual income taxation more satisfactorily.
4. Reduce discrimination in Federal excise taxation.

The purpose of our recent statement was only in part to urge the particular set of tax reforms that CED recommends. The most important thing is that our tax system be thought through in terms of its long-run effects. I am not so naive as to think that tax policy can ever be entirely nonpolitical. Politics will always be a strong element in the combination of forces that produces tax policy. But we believe that it is possible to increase the influence of economics and ethics in the mixture.

This subcommittee, with Congressman Mills as chairman, has made a valuable contribution to a higher level of tax thinking in this country. CED proposes a further step. We recommend that the Joint Committee on Internal Revenue Taxation, which includes the ranking members of the tax-writing committees, should set up an advisory committee. This committee should be representative of business, labor, agriculture, and consumers' groups. It should study the Federal tax system fundamentally and comprehensively and report to the joint committee.

One of the great obstacles to tax reform in this country is the wide and persistent divergence of views. Hearings are held. People come and state their traditional positions. And in the end no one has changed his mind and we are no closer to agreement. One virtue of the committee we recommend is that it would require people of different backgrounds to sit down together, try to find their area of agreement, widen that area if possible, and identify the sources of their disagreement.

We are now confronted with a Federal budget which has grown enormously without critical examination or any attempt at overall coordination. We have tended to accept it on the basis that it was either the result of past wars or necessary to prevent new ones. Realistic consideration of the budget shows that we are excusing ourselves and are not facing issues squarely.

The present Federal tax system has grown up in much the same way. It was based upon war needs and it was not expected that it would be continued either at the present levels or in the present form. The combination of high expenditures and unhealthy tax structure is one of the most vital problems facing the Nation. If we are to enjoy increased growth and improved standards of living, which we all want, we must examine our fiscal situation with complete courage and a minimum of political bias. The present deplorable inflationary situation arises partly from governmental policy. It is already an intolerable burden and a threat to the future. If the present interest on the part of the public and Congress over the budget continues, we may be on the track to correcting our major evils. If we do, it will be a turning point in our history and a victory for all of us.

Suggestions for cutting nondefense expenditures in fiscal year 1958

Program	Amount of reduction	Remarks
	Millions	
FNMA secondary mortgage purchase program.	$500	This program was intended to alleviate temporary shortages of mortgages, not to insulate the mortgage market from general monetary policy. The proposed cut would reduce FNMA purchases under this program to the 1956 level. There would be little need for additional Federal funds if Federal agencies that insure and guarantee mortgages were given the authority to meet the mortgage rates prevailing in the market place.
Postponement of public works construction.	450	This would cut in half the projected increase in Federal construction (other than highways) between fiscal years 1957 and 1958. A slowing down of Federal construction is desirable so long as the demands for nongovernmental needs remain high.
Agricultural Conservation Service.	230	This program in effect shares with the farmers the cost of many current outlays for crop cultivation. By encouraging farmers to increase production, this program is actually in conflict with other agricultural programs, like the conservation reserve and the soil bank, which are intended to promote a reduction of farm production. Elimination of this program would not have any effect on the soil conservation program, which was designed as a long-run conservation measure. In addition to this step, the permissible price support levels should be lowered for future crops, but such action would have little effect on the fiscal 1958 budget.
Improvement of airways facilities.	200	A system of user charges should be developed to pay for the estimated increase in expenditures between fiscal years 1956 and 1958 for the improvement of airway facilities. This is consistent with a recommendation made by the President in the budget message and repeated in his letter to the Speaker dated Apr. 18, 1957.
Federal aid for school construction.	185	This is a proposed Federal program which will eventually cost at least $2 billion. CED has not studied the evidence sufficiently to determine whether there is need for Federal aid in this area. It is my personal opinion that this program should be deferred and restudied.
Stockpiling and other mineral purchase programs.	175	Current plans call for purchases of minerals amounting to $350 million in fiscal year 1958. Much of the program has little defense justification but has become a means of price support.
Veterans' benefits	100	This would eliminate the proposed increase for implementing the Bradley Commission recommendations. The necessary reforms to improve the equity of veterans payments should be financed by lowering excessive payments for non-service-connected illnesses and disabilities.
Federal aid for the construction of waste treatment facilities.	60	This is a program for Federal aid in an area which should be reserved entirely to the local and/or State governments, since sewage disposal is a local problem.
Area assistance	10	This program, which is intended to assist depressed areas, should not be financed with Federal funds. Although estimated expenditures in the fiscal year are small, this is the type of program that is likely to become very large once it is permanently established.

NOTE.—Total estimated reduction in cash expenditures in fiscal year 1958, $1,910 million.

Mr. WILDE. My summary will not be as good as the paper, so I hope you will have an opportunity to read the paper.

Senator O'MAHONEY. That is just piling up homework for us.

Mr. WILDE. First, may I point out that, since its inception, CED has been an organization which emphasizes the positive. It has never been a blind critic of public or governmental activities. It does not take that position at this time. However, as a result of its analytical and objective weighing of the present problem, it has reached the conclusion that there is imperative need for restraint in the growdth of Government expenditure and that, furthermore, reduction and reform in the present tax structure is equally required. The reasons for this position and the detailed arguments in support cannot be expanded fully at this time. They are set forth to some extent in the piece presented to this committee and to a greater extent in our policy statement, entitled "Tax Reduction and Tax Reform—When and How."

One of the very vital and fundamental objections that should be raised in connection with the present rate of Government expenditures and present tax structure is their relationship to the inflationary trends in the country. Most thoughtful people are deeply concerned with inflation and the erosion in the buying power of our money. Inflation is an unauthorized redistribution of the Nation's resources. It is particularly unfair to the large groups of our citizens who because of age or their employment status are unable to overcome it. In other words, inflation is particularly unfair to the weak.

Too many are accepting a defeatist and hopeless attitude concerning inflation. True, the cure of inflation is a complex and controversial subject because the causes and their relative weight are not universally agreed upon. Certainly one of the predominant cost-push forces today is the volume and nature of governmental expenditures. These disbursements are made almost regardless of the State of the market or of the prices required to secure material or services. This is particularly true in the defense sector. As a result, there is constant upward pressure on prices. It is difficult for a Government contractor to resist wage increases and material increases. This situation strongly influences the price structure throughout the whole economy.

Many of us believe one of the principal reasons the Federal budget has been so difficult to control is because of the widespread acceptance of the idea that defense expenditures and other expenditures related to past wars must have—and we agree on this—a higher priority, and that they have to be accepted as pretty much in the form that those who prepare them give them to us. Then, because this part of the budget is so large, many say we cannot reduce the civilian portion of the budget, no matter how that is defined, in an amount sufficient to make worthwhile savings. This overall counsel of despair is not a judgment we ought to accept. The defense budget can be cut in the opinion of many well-informed people and without serious jeopardy to national safety.

There is a common belief, supported certainly in part by the evidence, that each service branch strives to build up the necessary material and personnel to support its own theory of the best strategy and tactics for the country's defense. Certainly to the extent that this is true, the overall expenditures are bound to be larger than would flow from considerations of overall strategy and tactics if we had true coordination.

In the nondefense portion of the budget, few dispute the claim that important savings could be made if Congress were to change certain policy decisions.

Those are in the area particularly of agriculture, mortgage financial support, stockpiling, public works, Federal school grants, et cetera. If Congress believes that a reduction in Federal expenditures is needed—and there is much evidence that it is—there is little doubt that important reductions can be effected. One of the most helpful ways of achieving it would be to give the President the power of item veto. Such a veto could always be overruled, if in the judgment of Congress after hearing the President's objection the item was still worthy of restoration.

On the subject of the general state of the economy, there is an observation which, in my opinion, should be made. I refer to the fact that many who are concerned with full employment—and we all are—feel that even if the general state of the Nation is good, action should be taken with respect to any sector which is, for the moment, not vigorous. This—to me—would be one of the most serious mistakes that could be made. If we are to maintain a free society and an economy marching forward steadily, we need to permit the market place to make interior corrections. Two examples are the automobile and housing field.

In 1955 we had a boom in automobile production and distribution. As things turned out, this more than satisfied the market for the immediate future. Therefore, we had a fall-off in demand in 1956, and apparently 1957 will also be below 1955 in output and consumption. If we had tried to stimulate production in 1956 by direct Government intervention, in the long run it could quite likely have been a disservice to the industry and the workers in it.

The situation is more complex in the housing field, but to an extent the same story is true. We built more houses throughout 1955 and early 1956 in many areas than the market would readily absorb. There was a dropoff in housing starts in 1956 and 1957 which was in part due to the lack of demand and not due solely to the reduction in the amount of mortgage money available.

The point I wish to make is that corrections with respect to the supply and demand situation, in particular categories of consumer or capital goods, should be permitted to work themselves out without the interference of the heavy hand of Government. We cannot have a healthy economy if we interfere with every facet of it every time there is a change in employment conditions.

Finally, may I say that, if we are to continue a healthy growth in this country, we will have to add to our present capital resources. The opportunity to save and the incentive for the investment of capital in both speculative and established areas is vital. There is every evidence that real capital will be short in the years ahead unless we use every reasonable means to increase it. The present tax structure is one of our major handicaps in building up funds for our capital needs.

You will find attached to my statement certain figures relating to the budget and indicating that proposed cash expenditures in fiscal year 1958 could be reduced by at least $3 billion. I wouldn't claim that the figures are particularly precise or perfect. They do illustrate a pattern and the areas that desire the serious attention of the Congress.

Mr. Chairman, may I say that you and Congressman Mills and the others ought to be congratulated for taking time from your busy public service to hold these meetings. I hope my statement will be helpful to you and I would like to thank you for the work this committee has done.

Senator O'Mahoney. We appreciate very much your coming to the session of the committee. Our great regret is that all the members of the committee simply cannot possibly be present during these discussions. We do keep a full record of course of everything that is presented, everything that is said, and it will be taken into consideration in the executive sessions of the committee.

I have always felt that it is productive of great good with such a panel as is assembled here today and we can promote interchange among the panels for the benefit of the committee members, but because the panelists can ask keen questions dealing with the subject matter with which they are in daily familiarity.

Members of Congress, on the other hand, are constantly under demand for details of the effect of Government upon people, problems that individual citizens have, and the reports of committees on all of the subject matters that the Congress has to legislate upon, and sometimes I think it is a wonder that we don't make many more mistakes than we do.

Thank you very much, Mr. Wilde.

The next panelist will be Mr. Fackler, assistant director of the Department of Economic Research of the United States Chamber of Commerce.

STATEMENT OF WALTER D. FACKLER, ASSISTANT DIRECTOR OF ECONOMIC RESEARCH, UNITED STATES CHAMBER OF COMMERCE

Mr. FACKLER. Senator and gentlemen, my name is Walter Fackler. I am assistant director of economic research for the National Chamber of Commerce.

We appreciate the opportunity to come here this morning to present our views and current fiscal policies and the impact of those fiscal policies on the economic system.

As did Mr. Wilde, I will merely summarize some of the main points in my prepared statement.

Senator O'MAHONEY. The same rule will apply with respect to your statement.

(Mr. Fackler's prepared statement follows:)

STATEMENT OF WALTER D. FACKLER, ASSISTANT DIRECTOR OF ECONOMIC RESEARCH FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

I am Walter D. Fackler, assistant director of economic research for the Chamber of Commerce of the United States. I appear at the invitation of the committee on behalf of that organization. The National Chamber of Commerce is pleased to have this opportunity to present its views on current fiscal policies and the impact of those fiscal policies on the economic system.

THE FEDERAL BUDGET

The national chamber has been, and is, vigorously advocating substantial cuts in the proposed 1958 Federal budget. There are several fundamental reasons why we believe a reduction in Federal spending is imperative. First, during a period when continuing heavy demands must be made on the economy to provide for national security, it is essential that all nonessential Federal activities be kept to a minimum. It is simply good economics to put first things first. Second, there can be no doubt greater efficiency in the operation of Federal programs is both possible and feasible. Again, it is simply good economics to provide essential Federal services at the least possible cost, the least possible diversion of resources from other productive employments, and the least possible reduction of the real personal income of taxpayers. Third, rigorous Government economy is the key to tax reform, balanced economic growth and future economic stability. Continuous expansion of Federal spending creates insatiable demands for increased tax revenues and results in perpetual postponement of the long-overdue revision and reform of our uneconomic tax system.

We recognize full well that international and domestic responsibilities of the Federal Government require, and will probably continue to require, very substantial Federal outlays. We know that national defense does not come cheap and that certain kinds of Federal expenses will continue to grow. But we have tried to take a responsible, sensible approach to curbing excesses and promoting fiscal policies which, we believe, are in the long-run interests of the economy and the country. We have taken the reasonable position that all spending programs which are not strictly essential must be treated as luxuries and not promoted at the expense of other more important economic goals. We have urged that Congress follow the principle of eliminating those Federal functions which can be performed more efficiently or economically by State and local governments or other agencies, public or private, or which more properly should be performed by State and local governments. We have reiterated what is well-known by all serious students of governmental operations, that energetic legislative and administrative action can promote efficiency and improve governmental operations at lower costs without the sacrifice of essential services. We have repeatedly pointed out that building up the long-run productive capacities of the country is not only the first line of defense, but also the only path to a broader, deeper tax base from which all future governmental services must be provided. In short, we do not make blind demands for false economy, but a plea for more responsible Government.

Present economic conditions are propitious for at least a start toward fiscal reform. During prosperity the economic health of the country is improved by a reduction of Federal spending and Federal debt. Such fiscal action would reinforce monetary policy and aid in maintaining stable prices and full employment. Private investment expenditures are still rising, albeit at a less rapid rate; State and local governments are increasing their expenditures, especially on public construction; the economic outlook is still generally optimistic. What better time to reduce Federal spending, Federal debt, and lay plans for tax reforms designed to increase the real output of goods? If we do not have the political maturity to do these things under present prosperous conditions, it seems academic to talk about the future adaptation of fiscal policies to the objectives of the Employment Act of 1946—maximum employment, stable economic growth, and stable prices.

It was with the foregoing considerations in mind that the national chamber, after much serious study, made specific recommendations for reductions in Federal spending which would amount to approximately $5 billion. It was felt that the budget could be reduced, without damage, in this amount, and thereby make some tax revision possible—lower surtax rates on personal income, especially in the rapidly progressive middle range, a reduction of corporate rates, perhaps by two percentage points and selective rollback of some of the "temporary" wartime excise rates—and at the same time provide for further reduction of the Federal debt. Unfortunately, lower tax rates seem out of the question this year, but it is not too late to take action to curb Federal spending and to make longer range plans for tax rationalization over the next few years.

Naturally, what can and should be done depends, in part, on unpredicable future economic conditions. If inflationary pressures continue, reduction of Federal spending is all the more important. In event of recession, tax reductions will be even more urgent. But no progress can be made if a defeatist attitude is taken toward the Federal budget. Government economy now is both feasible and wise.

GOVERNMENT RESTRAINT

Although there appears to be a sincere desire on the part of the administration and in the Congress to restrain unnecessary growth of Federal expenditures, there also seems to be considerable pessimism about the possibility of maintaining firm control. In some quarters, both in and out of Government, there almost seems to be a passive feeling of resignation that Federal spending and Federal activities will inevitably increase in geometric proportion according to some kind of "Parkinson's law," in spite of all well-intentioned efforts to exercise restraint.

Recently, it has been pointed out by a number of private and governmental observers that budget cuts made or to be made will have minor or negligible effects on Federal cash spending in the forthcoming fiscal year. They reason as follows: Much Federal spending will come from large carryover appropriations and previous authorizations; some budget reductions merely involve a bookkeeping postponement of appropriations and do not, therefore, curtail immediate or anticipated spending; and before the end of the coming fiscal year, deficiency appropriations will be needed to restore some of the cuts now being made.

Though such fears are not without some foundation, we reject this pessimistic approach, for it represents an abdication from fiscal responsibility—it borders on political delinquency. Even though Federal cash payments in the next year or so will, in part, be determined by past action, any legitimate economies we can make now will reduce those payments to a lower level, and provide for some debt reduction which otherwise would not be possible. Furthermore, future spending depends, in large part, on budgetary decisions made now. According to present estimates, Federal spending will increase by approximately $3 billion in fiscal year 1959—based on past and current budgetary decisions; 1960 looms just beyond. We cannot dodge fiscal responsibility by taking a hand-to-mouth approach which permits us to complain in each succeeding year that "nothing can be done" because of decisions made in previous years. To be sure, many governmental operations, like business operations, require long-range planning and long-range commitments. But we are still masters of our fiscal fate, and even long-range decisions must be flexible enough to permit change and aqeuate control.

Often, too, in recent discussions we have heard naive and vague attempts to justify expanded Federal spending on the grounds that it represents no increase in the proportion of national output absorbed by the Federal Government, or on the grounds that population and productivity are increasing. Although such global comparisons of the public sector with the private sector may have some limited validity, when used in connection with other qualitative factors, in assessing the economic impact of Government, it is hard to imagine a more irrational approach to budget formulation.

Such arguments implicitly assume that some set proportion of our national output should be consumed collectively by the public through the agency of the Federal Government. If so, what proportion—5, 15, 25, 50, or 100 percent? Also this "proportional" approach assumes that when productivity increases in the private sector of the economy, automatically the Federal Government should rush to absorb some of the increases and deprive the consumer of his freedom to choose the form in which he takes additional fruits of his labor or innovation. The cynic might term this a "parasitic" approach to Government.

The "proportional" approach also ignores the rapid increase in State and local expenditures. When such expenditures are expanding rapidly and the Federal Government insists on expanding also to maintain some set ratio of spending to output, the combined load of government—Federal, State, and local—on the taxpayer, actually increases faster than output and income.

For what it is worth, it is interesting to note that the combined purchases of output by Federal, State and local governments for purposes other than national security have actually been increasing in recent years more rapidly than output. Based an estimates of the Treasury and Council of Economic Advisers as to output, personal income and Government spending during the calendar year 1957, the picture is as follows:

	Total (percent)	Per capita (percent)
Increase in gross national product:		
1953–57	18.3	10.4
1955–57	10.1	6.2
Increase in personal incomes:		
1953–57	18.8	11.5
1955–57	11.0	7.2
Increase in combined governmental purchases of output excluding national security:		
1953–57	24.6	16.0
1955–57	15.2	11.2

Of course there is no magic formula or proportion. Governmental expenditures and governmental functions should be determined by demands of the public, an evaluation of alternatives sacrificed, and economic conditions. People must be left free to decide whether they want more or fewer Federal "services" or whether they prefer to take increases in output in the form of State and local services, or larger real private incomes. Rational fiscal planning requires restraint, discipline, and economy.

TAX REFORM

In testimony before the Joint Economic Committee last February, I made the following statement:

"It is now proposed that Federal spending be further extended into new areas. Each year new commitments are made which will automatically increase future budgets, and so year after year the long-overdue revision and adjustment of our chaotic Federal tax structure is expediently postponed. Instead of the unnecessary preoccupation with local and State problems, we respectfully suggest that, in the interest of balanced, orderly economic growth, it is more important to give immediate and serious study to the effects of our present tax structure and operation of our economy.

"This is a difficult, complex, and uncomfortable problem; and it will become increasingly difficult to cope with as time passes and tax-induced distortions work their way more permanently into the fabric of our economic life. There is need to consider carefully how excise taxes affect the allocation of resources; how excessive and discriminatory personal income tax rates affect the direction of investment, job opportunity, and the structure of industry; how present corporate taxes affect prices, income distribution, methods of business finance, and the structure of industry; and how the combined effects of our present personal and corporation income tax levies distort the pattern of our economic growth."

This statement is pertinent to the inquiry of this subcommittee. It is being reinforced by an increasing public awareness that something must be done soon. Recently in an excellent policy statement (Tax Reduction and Tax Reform—When and How, May 1957,) the Committee for Economic Development discussed the need for tax reform in such clear and forthright terms as these:

"How to keep Federal expenditures from rising at a rate that absorbs all available tax revenues generated by economic growth is perhaps the most important issue facing the Nation today.

"* * * The Nation would benefit more from tax reduction than from a number of governmental programs.

"The major deficiency of the Federal revenue system is that it pays too little attention to the requirements of an economy that depends primarily on the free choice of individuals and business for production and expansion."

While we do not necessarily agree with CED on all matters of specific detail, we do vigorously support the principles espoused in the report, and congratulate them on a noteworthy and well-reasoned addition to public debate and education.

Appended hereto is a copy of a short note entitled "Reflections on Tax Policy," which we published in the May 1957 issue of Economic Intelligence, which points up some of the major tax issues, with special emphasis on the Federal personal income tax. It should be considered a part of this statement by reference.

In this article we point out that the ability of individuals to pay taxes is not the same as the ability of the economy as a whole to pay taxes, that the present tax structure is reducing the diversity of investment and job opportunity and restricting the growth of the tax base, that small business is being penalized and capital immobilized, and that present rates work against the wider distribution of property. In sum, we hold that it is not enough for Government to be merely economical in spending, but also it must levy taxes in a fair and economical manner.

In event of a business downturn, prompt tax relief would, of course, help to stabilize private spending. But even under continued inflationary pressures, tax adjustments could be made which would ease the task of inflation control. It is too often overlooked that present high rates of taxation place an undue burden on monetary controls and reduce their effectiveness. Since interest expenses are deductible for tax purposes, the real rate of interest paid by a borrower depends in large measure on how high the tax rates are. Interest rates must rise higher than they otherwise would to restrict the demand of both personal and corporate borrowers subject to high marginal tax rates. Also, to the extent that high tax rates reduce the diversity of investment and distort the pattern of economic growth, the output of goods and services does not increase as rapidly as it should. A more rapidly increasing supply of products would dampen inflationary pressures on the price level.

We cannot go into the ramifications of tax reform in this short statement. The problems are many and complicated. But it is important to stress that on all counts—to minimize the dangers of both deflation and inflation and promote balanced economic growth—tax reform is an immediate and pressing problem.

DEBT MANAGEMENT

The Treasury faces uncomfortable debt problems. In spite of good intentions and valiant efforts to lengthen the debt and develop a more manageable maturity pattern, the floating debt had not been reduced and continuous large-scale refinancing must be carried on in a tight-money market.

Rational stabilization policy, of course, would call for funding of short-term debt into long-term during boom periods to reinforce monetary policy and siphon off some of the funds that otherwise would go to swell private spending on current output. But such operations by the Treasury would act to depress bond prices and drive interest rates even higher. In light of the very vocal opposition in some quarters to so-called tight money and rising debt service charges, the Treasury has not been able to make much headway in carrying out refinancing plans or to use debt management as an auxiliary instrument of economic stabilization. Success for keeping inflation fairly well under control we owe, not to fiscal policies, but to the wisdom and courage of Federal Reserve policies. This is not to say that the administration has sought to undermine Federal Reserve policies, but neither has it been in a position to lend the Federal Reserve much help.

In the months ahead, substantial amounts of debt will have to be refinanced. Although it is possible there may be some easing of the money market later, we still must face the fact that the market will probably remain tight. Short-term rates are high, and funding into longer term issues is going to make the market tighter. The only alternative to these high rates is deliberate inflation—a high price to pay for minor savings in debt service charges. To the extent that Government expenditures are cut and surpluses are made available for debt retirement, there could be some minor easing of debt difficulties.

In any event, it is clear that debt policies tailored to economic circumstances, especially periods of inflation, are difficult to achieve. They cannot be achieved without some private and public irritations which as yet, as a nation, we do not seem willing to bear in our own best interests.

CONCLUSION

The task of this subcommittee is a difficult and, in many ways, a thankless one. Faced with the pitfalls of all economic forecasting, the conflicting claims on Government and on the economy, the inevitable disagreements over ends to be achieved and the appropriate means to achieve them, they must advise the Congress on the economic considerations which should be taken into account in shaping fiscal policies.

These hearings, however, are evidence of a growing public recognition that because Government policies, for good or ill, exert a tremendous influence on the economic life of the Nation, we cannot afford irresponsible government. We appreciate the opportunity to offer, in a constructive spirit, our views with the hope they will be of some assistance to the committee and make some contribution to fiscal responsibility.

ATTACHMENT

[From the Economic Intelligence, Economic Research Department, Chamber of Commerce of the United States, Washington 6, D. C., May 1957, No. 106]

REFLECTIONS ON TAX POLICY

In 1662 Sir William Petty, a man of great versatility and perspicacity, wrote A Treatise of Taxes and Contributions, which became a landmark in economic literature. In one perceptive section of his treatise, dealing with the "causes of the unquiet bearing of taxes," Petty made a clear distinction between the ability of particular individuals to bear taxes and the ability of the nation, or the economy as a whole, to support a taxload of a given size and composition. Almost 300 years later in recurrent discussions about "taxable capacity," Petty's distinction between the two different concepts of "ability to pay" is often forgotten. But failure to make this distinction results in confusion and uneconomic tax policies.

Of course, the taxable capacity of the economy is somehow related to the ability of individuals to pay, but it also depends on many other factors—the distribution of income, the kinds and rates of taxes, growth of the tax base, incentives and other reactions of the taxpayers and the combined impact of all taxes on the economy. Moreover, the relationship can be reversed. One can

93528—57——14

also say that the taxpaying ability of individuals depends, in large measure, on the performance of the economy which, in turn, is seriously affected by our tax system. High rates of taxation on individuals do not necessarily produce the largest total volume of tax revenues. Indeed, it is possible that blind application (and perversion) of the individual "ability to pay" principle has led not only to unjustifiable discrimination among individuals, but also has narrowed our tax base, distorted economic growth and reduced the ability of the economy as a whole to bear taxes.

TAX REFORM URGENTLY NEEDED

At present, we have a chaotic system of Federal taxes which has grown up largely as a result of political expediency and the exigencies of war finance. The system is an irrational hodgepodge of indiscriminate excises, punitive corporate income levies and confiscatory personal taxes with marginal (surtax) rates on personal income rising very rapidly on middle income groups up to 91 percent at the top. In addition, Federal taxes are superimposed on a multifarious system of State and local taxes. The combined result is a conglomerate tax structure which defies description or commonsense.

Surely there can be no doubt that our present tax structure does seriously affect the performance and the long-run pattern of growth of our economy. It capriciously changes the allocation of resources and the distribution of income, affects the direction and volume of private investment, plays an almost dominating role in methods of business and personal finance, changes the structure of industry and the pattern of regional development and limits the diversity of job opportunity.

Yet, these long-run considerations are pushed aside by short-run pressures. Long-overdue and long-promised Federal tax reform is put off year after year because of the growing revenue demands of ever-increasing Federal expenditures. In the meantime, long-run tax-induced distortions work themselves more firmly into the fabric of our economic life. Long-run adjustments—and maladjustments—once they have taken place, are not easily reversible. They can be modified and redirected only gradually. Tax reform, therefore, becomes more difficult the longer it is postponed. Here is a national problem of the first magnitude.

TAX RATES ON PERSONAL INCOME

Tax reform should start with personal income taxes. There is good reason to believe that a reduction in the highly progressive marginal rates (surtax bracket rates) would probably increase tax yields. Lower rates would relieve the pressure on individual investment incentives, allow new investment to flow more freely into channels previously dammed by tax deterrents and should produce substantial gains in productivity and income for the economy as a whole.

To be sure, there might be some temporary drop in tax revenues, but this would be rapidly offset by the increased tax yield from a wider and deeper tax base. The general validity of this argument was affirmed by the President's Cabinet Committee on Small Business in its progress report of August 6, 1956. In discussing an analogous proposal, that of reducing corporation income taxes for small business, the report states: "It is doubtful, however, whether there need be any loss [of revenue] to the Treasury in the long run. For, in the first place, some of the tax proposals involve merely a deferral of taxes and, in the second place, the proposed measures would tend to enlarge the national income which is the ultimate source of all tax revenues."

Most people fail to realize that only a small percentage of Federal revenue actually comes from highly progressive surtaxes. The yield from these confiscatory levies is estimated at approximately $6 billion annually—only 16 percent of the personal income tax revenue or 8 percent of all Federal tax revenue. It is obvious that the revenue loss from a rate reduction could be rapidly offset. Furthermore, one may well ask whether the small surtax yields are worth the loss of economic efficiency which they cause.

INVESTMENT AND JOB OPPORTUNITY

What many people also fail to realize is that highly progressive marginal tax rates, while irritating to the wealthy individual, actually bear most heavily on small business and wage earners at the lower end of the income scale. Tax deterrents to investments having a high degree of risk or to investments normally undertaken by small businesses reduce the income-earning opportunities of all workers by reducing the number of choices open to them in the job market. In other words, income-tax rates which put increasingly heavy penalties on success discourage people from "going into business for themselves," limit expansion of existing firms, and close employment opportunities to workers in jobs where they might be more productive.

The basic issue is not whether more reasonable tax rates would increase the total number of jobs or even total investment—after all we have high employment and high investment with our present tax system. The real issues are the kinds of jobs open, the kinds of investments made and who makes the investments. Greater diversification of venture capital and greater freedom in the redeployment of resources are necessary for maximum individual productivity and balanced economic growth.

Under our present tax system, we deny the low income worker the opportunity of paying income taxes, or reduce his ability to pay, by reducing diversity of investment opportunity and job opportunity. Perhaps it is time to reconsider what we really do mean by the "ability to pay" principle.

WHAT ABOUT SMALL BUSINESS?

Most small businesses in this country are unincorporated. Present personal income tax rates are a serious obstacle, not only to formation of new businesses, but also to the growth of small enterprises. Even an efficient small producer may get tired of fighting and lose his relish for risk-taking when the Government shares increasingly in any gains but doesn't share the losses. As a Nation, we find ourselves in the ridiculous posture of crying piously for the small-business man while at the same time blithely breaking his back with confiscatory taxes.

CAPITAL IMMOBILIZED

Apart from deterrents on investment and small business, highly progressive tax rates affect the efficiency of the economy in another way—by reducing the mobility of capital. Quite naturally, the present rate structure encourages corporations to retain earnings because dividends paid out are subject to double taxation at high personal rates. This prevents earnings and savings from flowing freely into the capital markets. Diversification, innovation, and investment tend to be more and more restricted within the ambit of existing firms rather than spread out into new ventures. Those who view mergers and the growth of internal corporate financing with alarm would do well to be also concerned about the indirect effects of our tax policies.

TAX-INDUCED CENTRALIZATION

Highly progressive personal tax rates work against the wider distribution of property. It is becoming increasingly difficult for young men of energy and imagination to accumulate even a modest estate. Prof. Lionel Robbins of the London School of Economics, commenting on British experience with prolonged confiscatory personal taxation, poses the question bluntly: "If our idea is not universal collectivism, but rather property-owning democracy, are we content with a tax system which is working all the time the other way?"

DO WE BEAR TAXES TOO QUIETLY?

The problem of tax reform is complex and politically difficult. No completely satisfactory formula for distributing the taxload has ever been devised. There will always be some chronic tax complaint. But, as Petty pointed out, "unquiet bearing of taxes" is justified when the state through ignorance or expediency persists in following tax policies which are damaging to the economy as a whole. Perhaps we are bearing our present Federal taxes too quietly. We continuously demand that the tax revenues collected by Government be economically spent. It is just as important that taxes be fairly and economically levied.

DIMINISHING RETURNS

Are Federal income taxes reaching the point of diminishing returns? Tax analysts frequently assert the point has been reached for persons in the highest tax brackets and cite as examples talented and popular entertainers, now rarely seen on movie television screens, because they already have such high incomes they would retain only some 5 percent of the compensation for appearance before the cameras, and Federal and State tax authorities would take the remaining 95 percent.

This example, though extreme, is more generally applicable than people realize, for Internal Revenue Service statistics indicate the point of diminishing returns was reached 4 years ago (latest data presently available) by almost a quarter million taxpayers, affected over one-sixth of all taxes collected, and is each year reaching a lower level of income.

Between 1950 and 1953 personal income rose 26 percent, the number of tax returns filed was up 41 percent, gross income reported on returns was up 33 percent, and tax liability up 60 percent. However, the number of returns with gross income of $100,000 and over was down 23 percent, total income reported on these returns was down 28 percent, and total tax liability for these returns was down 24 percent.

Between 1952 and 1953 personal income was up 5 percent, the number of tax returns filed rose 3 percent, gross income reported on returns was up 7 percent, and total tax liability was up 6 percent. However, the number of returns with $30,000 and over gross income was down 4 percent, income reported on these returns was down 6 percent, and the tax liability down 8 percent.

The point of diminishing returns has dropped steadily. In 1951 it was reached by persons with taxes equaling 60 percent of their gross income, in 1952 by those with taxes equaling 50 percent, and in 1953 by those with taxes equaling 31 percent of their gross income.

Congress, when considering future tax legislation, should carefully study its probable effect upon individual incentives.

Mr. Fackler. It is well known that the national chamber is advocating substantial reductions in governmental expenditures, and we think for very good and important reasons.

First, there are continuing heavy demands being made on the economy to provide for national security which makes it essential that we keep all nonessential spending to a minimum.

Second, we know that greater efficiency and economy in governmental operations are possible.

Third, we believe that rigorous economy is the key to badly needed tax reform and tax reduction, which are so vital to the economic growth.

We recognize that large Federal budgets are inevitable. We also know that national defense does not come cheap, but we have taken what we think is a responsible position: (1) That nonessential programs are luxuries and should be treated as such—that they should not be put ahead of more important economic goals; (2) that the Federal functions should be eliminated if they can more properly or efficiently be performed at the State or local level or by private enterprise; and (3) that governmental operations can be carried on at lower costs without sacrifice of essential services.

We believe that present economic conditions are propitious for at least a start toward Federal fiscal reform. During prosperity is the time to curb excessive Government spending and to retire Government debt. Unless we have the political maturity to do these things in boom periods, prosperous periods, it seems academic to talk about adapting fiscal policy to achieving of the future goals of the employment act of 1946.

We rejected the defeatist attitude toward the budget. Spending can be cut, and if it is cut we can make a start on tax reform and still retire some debt. Federal spending does not have to grow in some sort of geometric ratio or "Parkinson's law." Even though carryover and deficiency appropriations may increase Federal spending somewhat in the coming fiscal year, legitimate budget cuts made now will help keep them lower than they otherwise would be and will help in 1959 and 1960.

Future expending depends in part on decisions that are being made now. It is an abdication from fiscal responsibility to complain each year, year after year, that fiscal restraint is impossible because of past budgetary decisions. To be sure long-range plans are necessary, but they should be flexible and subject to adequate control. Too often we hear vague and naive attempts to justify growing expenditures on the ground that they do not absorb a larger proportion of growing national output or that the population and productivity are increasing.

Such comparisons may have some limited analytical validity for certain purposes, but it is hard to imagine a more irrational approach to budget formulation. Such a proportional approach assumes that there is some proper or correct proportion, that Federal spending should increase automatically when, through hard work, innovation, and new capital investment, pivate productivity and private incomes are increased. This approach also assumes that the Federal Government can ignore State and local expenditures in what it does.

State and local spending is increasing. As a matter of fact, the total Government purchases of output for nonsecurity purposes, that is, Federal, State, and local combined, have been increasing more rapidly in recent years than have output and income.

Since 1953 per capita output has increased slightly over 10 percent while per capita nonsecurity Government purchases have increased by 16 percent. Since 1955 per capita output has risen by 6.2 percent, while Government nonsecurity purchases on a per capita basis have increased by 11.2 percent. But, of course, there is no magic formula. Government functions and expenditures must be determined on the basis of need, alternatives, sacrifice, and economic conditions—also with a view to the long-run impact on our economic development.

In testimony before the Joint Committee in February I pointed out the urgent, the very urgent need, for Federal tax reforms in the interest of balanced economic growth. The need becomes more urgent with the passage of time. The process of growth is not readily reversible and the continuing impact of the tax structure is going to take a long time to overcome. Some of the distortions, which are being worked into our economic structure are going to be with us permanently.

I would like to publicly congratulate the Committee for Economic Development for its recent statement on tax policy and tax reform. In its statement CED says:

> How to keep the Federal expenditures from rising at a rate that absorbs all available tax revenues generated by economic growth is perhaps the most important domestic issue facing the Nation today.

They further state that the Nation would benefit more from tax reduction than from a number of governmental programs. We couldn't agree more strongly. In a short note appended to our prepared statement we have pointed out some of the important economic effects of our tax structure, with a special reference to the personal income tax code. I cannot go into detail in the short time allotted here, but I hope the committee will study it carefully. Uneconomic tax policies are a national problem begging for eary solution.

In event of a downturn in business activity, prompt tax relief would of course be wise and very helpful. But even under continued inflationary conditions, which may be with us for some time to come, some tax adjustments are necessary to promote economic growth, better allocation of resources, and greater productive capacity. Some tax adjustments, too, would be actually anti-inflationary in their effects.

As to debt management, the Treasury faces some uncomfortable problems. In spite of efforts to develop a longer, more manageable maturity pattern, the floating debt has not been reduced, and continuous large scale refinancing must be carried on in a tight money market. Vocal opposition to so-called tight money and rising debt service charges prevent the Treasury from giving much fiscal aid to the Federal Reserve in its fight to control inflation.

In the months ahead, substantial amounts of debt will have to be refinanced. Although it is possible there may be some easing of the money market later, we still must face the fact that the market will probably remain tight. Both short-term rates and long-term rates are high, and funding into longer term issues is going to make the capital market tighter. High interest rates produce some public and private irritations, but they are small as compared with the heavy costs of the only alternative—inflation.

In conclusion, I would like to say that the task of this subcommittee is a difficult and perhaps a thankless one. Governmental fiscal policies do exert a tremendous influence on our economic life. It is difficult to agree on proper fiscal policies, much less make them effective, but in a constructive spirit we offer our views with the hope that they will be of assistance to the committee and make some contribution to fiscal responsibility.

Thank you very much.

Representative MILLS. Thank you, Mr. Fackler.

Our next panelist is Mr. Ralph Robey, National Association of Manufacturers.

Mr. Robey, we are pleased to have you with us and you are recognized.

STATEMENT OF RALPH ROBEY, ECONOMIC ADVISER TO THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. ROBEY. Thank you, Mr. Chairman. I am Ralph Robey, economic adviser to the National Association of Manufacturers.

I appreciate the opportunity to appear here, since the subject matter of these hearings is of such significane to the economic vitality of our Nation. It is the opinion of the association I represent, and of myself, personally that there is pressing, current need for a thorough overhaul of the income-tax rate structure to minimize the tax impediments to sound economic growth.

It is, therefore, of some concern to us that the major emphasis so far in these hearings has been on the relation of tax policy to short-run economic considerations. There was a similar emphasis in the 1955 hearing and report. We have the impression that the earlier inquiry was of some influence in forestalling consideration by the Ways and Means Committee of tax reduction during the 1956 session. This result may seem vindicated by the persistency with which expenditures have moved upward in relation to increase in revenue from economic growth, but at the same time it does raise the question of whether this approach to the formation of tax policy offers any hope of fundamental diagnosis and cure.

There is in our view an underlying cause for the upsweep in total expenditures which suggests the need for a more aggressive and direct legislative approach to the consideration and enactment of tax-reduction legislation designed to release the tax blocks to healthy progress. This cause is the reversal in administration policy on spending and taxing brought into sharp focus by statements in the President's annual budget messages of the 2 preceding years.

Hopes for tax-rate moderation still ran high when, in the budget message for fiscal year 1956, released in January 1955, the President stated:

> However, further tax reduction remains a firm goal of the administration, and our policy is directed to achieving both the savings in expenditures and the economic growth that will make such reductions possible.

Next year, however, in his budget message for fiscal year 1957, tax reduction was subordinated to a new doctrine, when the President stated:

> Budget revenues now permit us to undertake some new and expanded programs * * *. This budget reflects that purpose.

My purpose here is not to argue the merits of this or that expenditure, but to emphasize that any and all expenditures based on this doctrine have the effect of favoring individual groups or segments of the economy at the expense of general taxpayer interest and the Nation's economic health. On the record, therefore, I believe we are justified in drawing two conclusions at this point:

1. In so long as deflationary conditions are not dominant and recognized by economists and other authorities, this type of inquiry directed to short-run economic considerations will tend to postpone indefinitely the time when the Congress will give serious consideration to thoroughgoing tax-reduction legislation; and

2. In so long as the Congress does not give serious consideration to this kind of tax reduction, the tendency in Government will be to consume all or the major part of revenue increase in stepped-up expenditures.

This self-defeating process has serious implications for achieving economic progress without a constant inflationary bias.

We like to think that our Nation's economy has grown tremendously since World War II, and there are some at least who associate this growth with Government intervention into the private economy. Actually, the growth in the past dozen years, measured in physical terms, averages out at only about the growth rate of the 60 years preceding the depression of the 1930's.

It takes but little reflection to see that the growth since World War II has been in spite of, not due to, the tremendous rate of Government expenditure and taxing. The next step is to understand that much of this growth, normal by past standards, has been made possible only by the inflation of the money supply, abetted by the increasing velocity with which money is used.

Even for the good ends of economic growth, inflation is heady medicine, posing its own dangers for economic stability and undermining the moral fabric of public and private institutions.

However, it must be recognized that, in the absence of adequate accumulation of private capital, through the normal process of business and personal savings, we must inflate or not grow so rapidly. The Government has no responsibility, or power in a free society, to force capital accumulation. But, if it is serious in its protestations in favor of stability in the purchasing power of the dollar, then it has an equally serious obligation to forego, or reverse, policies which place arbitrary limits on capital accumulation.

It is, fortunately, easy to identify the one means by which the Federal Government exercises arbitrary restraint on private savings, namely, through excessive, discriminatory rates of income tax, both on individual and corporate income. I don't believe this committee needs corroboration on this point, but for its forceful and penetrating character I append hereto an excerpt from the monthly letter of the First National City Bank of New York.

I have answered those who point to the record of economic growth since World War II as evidence there is nothing wrong with a discriminatory income tax rate policy, but ignore the price for such discrimination exacted in inflation.

I also have answered those who, for so many years, have in public and legislative forums associated excessive rates of income tax with the holding of wealth.

I intend no justification for the expropriation of wealth through any form of taxation when I state that income taxation is imposed upon income, not wealth. Excessive income taxation prevents the accumulation of wealth, but does not destroy wealth once acquired. It discriminates against all those who by the dint of their efforts and achievements move upward through the income levels. Of even greater economic if not moral importance, it indirectly discriminates the most against individuals, segments of our society, and sections of our Nation, who and which have the most to gain in the increased economic standards which come from increase in capital supply.

One of the paradoxes of this troubled era is our national capacity for diagnosing and prescribing for the economic ills of other nations, while blinking our eyes to the same conditions at home, namely, inadequate capital especially of the venturesome kind, loose fiscal policies, continued inflation. We see the bountiful returns from the prescription of fundamental cures in West Germany, but shy away from such strong medicine at home.

We live in a sort of dreamworld, in which national aggregates of production, income, and consumption blind us to the hopes and needs, as well as the pitfalls, of the future. Just as we have mistakenly associated income taxation with accumulated wealth, so have we become so impressed by our affluence, power, and wealth as compared with the rest of the world that we resist thought of the stern attitudes and policies needed to realize the promise of the future. With a population moving upward rapidly than the labor force, and with patterns of wants and aspirations of startling proportions developing within our families and communities, all of which spell capital need without visible limit, we mistake what we have today as proof that all will be well tomorrow. The cynics among us, in the colleges, in government, in industry, and in labor unions, accept inflation as a new way of life, but in this cynicism there is often a blindness to the inadequacies and limitations, even more the dangers and injustices, of utilizing inflation as a substitute for the free information of capital.

There is danger in excessive preoccupation with national aggregates because such figures do not disclose the desperate search for capital which goes on daily throughout the Nation. This search does not start in Washington, but at home, as witnessed by the State development commission, and many community projects, all directed to bringing in more capital to provide better jobs, increased living standards, and higher local tax bases. Movement of capital across State and community lines is an integral part of the free economic way, but movement is no substitute for creation in the first instance. All new capital must first be accumulated in the communities and States of the Union.

Nor do national aggregates disclose the differences in regional patterns, especially as between the South and the more heavily industrialized North.

Through use of imported capital, the South is coming along more rapidly in production and income growth than the rest of the Nation. After nearly a hundred years of a substandard economy, the South is rising toward a new dignity of economic equality with the rest of the country. But southerners especially should realize the absurdity and unfairness of a Federal tax system which strikes at the roots of the capacity of their homeland to grow even more rapidly and to control its own destiny by accumulating more capital out of its own growth.

Before concluding, I turn attention to the viewpoint expressed in these hearings and quite generally held in Washington, that a worthwhile tax reduction is dependent upon a visible budgetary surplus in the order of $3 billion to $5 billion or even more dollars. This view, purposely or not, accommodates the tendency of expenditures to rise with revenues. It also diverts attention both from the possibility of achieving a moderate rate scale by repetitive annual reduction, and from the control over expenditures which is inherent in the taxing power.

The total revenue now derived from the progressive part of the individual tax structure is only in the order of $5 billion to $6 billion, or about 17 percent of the total revenue derived from this tax. It is apparent, therefore, that relatively small annual reductions in these rates, measured in revenue dollars, would soon bring the entire range of progression down to a moderate and reasonable level. I would think that this fact alone would be a challenge to action of those in position to influence the course of tax action; a challenge which, if met, would resolve the central tax problem of small business and of all economic activity.

If tax reduction is not enacted at this session of the Congress, the revenue increase from economic growth will be unencumbered and thus available for great spending. It must not be overlooked that, within any given total of appropriations, there is considerable leeway for executive action to control the actual level of spending by use of the quarterly allotment procedure administered by the Bureau of the Budget under Presidential direction. In an administration like the present, which honors budget balance, this procedure is the means for holding current spending within the limits of available revenue.

Thus, enactment this summer of tax-reduction legislation, effective January 1, 1958, would in effect preempt revenue growth, while delay of enactment until the next session of the Congress inevitably would mean a lesser budget surplus and perhaps no tax reduction at all.

Moreover, enactment now also would limit the potential revenue which could be used by the executive branch as the basis of its January budget projections for fiscal year 1959.

To summarize, I have only three points:

1. One of the most inflationary forces in our economy is the system of high and discriminatory rates of income tax, which chokes off creation of new capital at its source, causes excessive reliance for economic expansion on bank credit, and distorts or prevents natural patterns of economic growth.

2. Whatever merit there may be in expenditures under separate Federal programs and projects, there is no merit in a total expenditure level which prevents attention to an immediate and continuing program of reduction in the excessive rates of income tax until such time as an equitable, bearable, and noninflationary level of rates is achieved.

3. We are looking in the wrong mirror when tax policy is viewed from the standpoint of short-term economic trends instead of from the continuing and increasing need of the economy for the generation of more capital out of the normal processes of individual and business savings.

Excerpt from the First National City Bank monthly letter, October 1956:

> The plain truth is that expansion in Federal spending programs, appealing as individual programs may seem in themselves, is siphoning off the natural growth of the revenues which otherwise could finance tax-rate relief. This is not merely a matter of comfort for individual hard-pressed taxpayers.. The striking fact in the United States today is the shortage of capital in relation to demands. To grow, the country needs a larger savings flow. Lightening the crushing burden of taxation could refresh the springs of individual incentive and initiative, enlarge the savings flow, and take some of the load off credit policy as a block againt inflation.
>
> The practical alternative is to risk a return to big government, drift once more toward the welfare state, where the only relief from taxation is perpetual inflation.

Representative MILLS. Thank you, sir.

Our next panelist is Nathaniel Goldfinger, economist, research department of the American Federation of Labor and Congress of Industrial Organizations.

Mr. Goldfinger, we are pleased to have you with us, and you are recognized.

STATEMENT OF NATHANIEL GOLDFINGER, ECONOMIST, RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. GOLDFINGER. Thank you, Mr. Chairman.

I am Nathaniel Goldfinger, economist, department of research, AFL-CIO.

I should like to thank this committee for the opportunity to present this statement on fiscal policy. I would like to submit the statement for the record and to proceed by summarizing it.

Representative MILLS. You may proceed in your own way, and it is understood that the entire statement of every panelist will be in the record if any parts are omitted in the oral statement.

(Mr. Goldfinger's prepared statement follows:)

STATEMENT OF NATHANIEL GOLDFINGER, ECONOMIST, DEPARTMENT OF RESEARCH, AFL-CIO

I should like to thank this committee for the opportunity to present this statement on fiscal policy.

Before discussing a few major issues of importance for fiscal policy, I should like to emphasize the following, concerning the current economic scene:

National economic activities have been in a lull for 8 months. There have been no sharply rising pressures for goods and services. Changes in the level of economic activities have been largely seasonal.

Industrial production has remained at approximately the same level since last October, after adjusting for seasonal changes. Expenditures for new construction (seasonally adjusted) have been about the same since last July. Retail sales (seasonally adjusted) have remained at about the same level since November. The volume of the Nation's total output of all goods and services was approximately the same in the first quarter of 1957 as in the fourth quarter of 1956. This lull is continuing in the current second quarter of the year.

Residential construction has been declining since 1955. Production and sale of automobiles and many other lines of consumer goods have remained relatively soft for a year and more. There has been some downward drift in recent months, in several other types of economic activities, such as steel output. Although the backlog of orders for goods is still high, the value of new orders placed with manufacturers has been slipping for several consecutive months. Manufacturing employment has been declining for 6 months and total nonfarm wage and salary employment has remained the same in the past half year, after accounting for seasonal changes.

There are expectations of some pickup in the level of economic activities in the fourth quarter of 1957, after a year of a lull in demand and an increase in the economy's capacity to produce. These expectations are based largely on an anticipation that Government spending will continue to rise and on hopes that the long decline in residential construction is ending, and that the activities of the automobile and related industries will move up after the automobile model changeover. Even if the expected pickup should materialize in the fourth quarter of the year, there is no current sign of anything like a buildup of inflationary demand.

There has been no indication in recent months that the demand for goods and services, in any major part of the economy, is pressing against the economy's capacity to produce. Neither is there any indication of such demand pressures arising in the months ahead. On the contrary, there are growing gaps between productive capacity and demand. There are numerous soft spots at present; sagging demand for a wide variety of products, inventory reductions, an increasing capacity to produce a rising volume of goods and services, advancing productivity, and widespread small layoffs in many industries.

There is no economic justification for the view that vitally needed public programs, such as Government aid for school construction, should be postponed lest they create inflationary pressures. The lull in the level of national economic activities during the past 8 months indicates rather clearly that the fear of an inflation—that would supposedly arise if the Government attempted to meet some of the public-welfare needs of the American people—is without foundation.

This supposed fear of a build-up of inflationary demand, in the face of slipping demand in many industries and a rising capacity to produce, seems to be nothing more than a smokescreen attempt to defeat such measures as school construction, Government aid for distressed areas, extension of the Federal minimum wage to millions of low-paid workers in trades and services, and an expanding housing program. These public programs are based on real social needs and should be considered on their own merits.

UNBALANCED ECONOMIC GROWTH

Economic developments in the past several years have been characterized by a lack of balance between business investment and personal consumption. Continuation of such an unbalanced condition in the period ahead will undermine the health of our economic system. It was a similar and pronounced lack of balance between investment and consumption during the 1920's that helped to bring on the great depression of the 1930's.

In the 3 years between 1953 and 1956, business expenditures for new plant and equipment rose 23.9 percent. This represents a rise in investment for capital goods and equipment, whose purpose is to increase industry's ability to produce a rising volume of goods and services.

While such investment in new plant and equipment was rising sharply between 1953 and 1956, personal consumption expenditures increased only 10.9 percent. Consumer spending for goods and services in those 3 years increased less than half as fast as business outlays for new plant and equipment.

Lopsided economic development

[In billions]

	Business expenditures for new plant and equipment	Personal consumption expenditures
1956	$35.08	$265.7
1953	$28.32	230.5
1953-56 percent change	+23.9	+10.9

Source: Department of Commerce and Securities and Exchange Commission.

This distortion in the growth of our national economy in recent years can be seen more clearly when we view it in perspective. Plant and equipment outlays were not depressed in 1953, they were not low in relationship to consumption. Indeed, business investment in new plant and equipment has been rising at an extremely sharp rate since 1945. Between 1945 and 1950, when business attempted to make up for the many depression and war years of low investment, outlays for new plant and equipment rose 139 percent. With the outbreak of the Korean War in 1950, the Government stimulated a further sharp boost in business investment in new plant and equipment, through the 5-year depreciation program. The Government simultaneously followed a policy, after the outbreak of the Korean War, of restraining personal consumption, during the national defense buildup, through various income and credit regulations. Between 1950 and 1953, investment in new plant and equipment rose an additional 24 percent.

It was from this high level of outlays for new plant and equipment in 1953—and from this already unbalanced condition between investment and consumption—that the significantly unbalanced growth between investment and consumption has occurred in recent peacetime years.

The period following the end of the Korean war and the peak of the national defense buildup should have seen the development of a new balance between consumption and investment. Such balance, following mid-1953, required policies by private groups and Government to stimulate rising personal consumption—not only in dollar volume, but also in relation to business investment and to the volume of national production.

Instead of emphasis on the growth of personal consumption. there has been an all-out emphasis on stimulating new plant and equipment investment. Instead of a developing balance between investment and consumption, there has been a growing lack of balance between the economy's ability to produce and its ability to consume.

UNBALANCED FLOW OF INCOMES

The distorted growth of the national economy in the past 3 years arises from a lopsided flow of spendable cash to the different sectors of our economic system. In the years since 1953, the flow of cash to corporations has risen at a considerably faster rate than personal income.

Between 1953 and 1956, total wages and salaries rose 14.7 percent. This represents the increase in the before-tax total income of the vast majority of the consuming public.

In contrast, corporate profits before taxes rose 18.1 percent between 1953 and 1956. Profits after taxes increased almost 30 percent.

Dividend payments by corporations to a tiny segment of American families increased 29 percent in those years. Retained corporate earnings (profits after payment of taxes and dividends) rose 31 percent.

Comparison of labor income with corporate income 1953–56

	Percent
Wages and salaries	+14.7
Profits before taxes	+18.1
Profits after taxes	+29.9
Dividends	+29.0
Retained profits	+31.1

Source: Department of Commerce.

The above contrast, however, is not complete. It omits the effect of rapidly rising depreciation allowances on the flow of cash available to corporations. Although a corporation's depreciation charges are accounted for as a cost of doing business, they provide a flow of untaxed cash into the firm. When we add the rise in depreciation allowances to the rise in retained profits (after payment of taxes and dividends), we can obtain a picture of the sharp increase in the cash flow to corporations.

Between 1953 and 1956, the cash flow to corporations rose 37.7 percent. This sharp rise in 3 years helped to create the basis for the sharp increase in new plant and equipment outlays.

Total after-tax personal incomes, however, increased only 14.6 percent between 1953 and 1956, while the cash flow to corporations was increasing 37.7 percent.

Unbalanced cash flows

[In billions]

	Cash flow to corporations [1]	Disposable personal income
1956	[2] $25.2	$286.7
1953	$18.3	$250.2
1953–56 percent change	+37.7	+14.6

[1] Retained profits plus depreciation allowances of all United States corporations, excluding banks and insurance companies.
[2] Estimate.

Source: Economic Report of the President, January 1957, and Department of Commerce.

The distortion between investment and consumption between 1953 and 1956, therefore, rested on an unbalanced flow of spendable cash to these two different private sectors of the national economy.

The cash flow to corporations rose 2½ times faster than after-tax personal income between 1953 and 1956. Business outlays for new plant and equipment rose more than twice as fast as personal consumption expenditures in those 3 years.

Unbalanced cash flows and expenditures, 1953–56

	Percent
Cash flow to corporations [1]	+37.7
Business expenditures for new plant and equipment	+23.9
Disposable personal income	+14.6
Personal consumption expenditures	+10.9

[1] Excludes banks and insurance companies.

Source: Economic Report of the President, January 1957, Department of Commerce, and Securities and Exchange Commission.

The lack of balance between corporate investment income and personal consumption income between 1953 and 1956 has been due to several factors. One of them is the pricing policies—and internal financing of new investment—of the major corporations in the Nation's key industries, in which price competition is largely absent.

Another factor that stimulated this unbalanced flow of spendable cash and contributed to the distorted pattern of economic growth, since 1953, has been the Government's fiscal policy. The tax policy that has been followed in recent years has been one of stimulating investment and placing all-out emphasis on business investment.

In November 1950—after the outbreak of the Korean war and the start of the national defense buildup—the Government resumed a policy of granting

5-year depreciation for a wide variety of new plant and equipment, as a means of stimulating large-scale investment and of building a wide defense mobilization base. The 5-year depreciation program continues today, long after the end of the Korean war and long after the peak of the mobilization base buildup. The program declined sharply between mid-1952 and mid-1955. Toward the end of 1955, however, it was revived as a large-scale program. In the fourth quarter of 1955 and the first quarter of 1956, amounts certified for 5-year depreciation rose sharply to levels achieved during the Korean war. This occurred after plant and equipment outlays had already begun to rise sharply and after the rapid depreciation provision of the 1954 tax law changes had gone into effect.

In other words, the administration's revival of the 5-year depreciation program, under existing tax law, contributed to the investment boom of 1956 and to the distorted relationship between investment and consumption.

The Government's share of responsibility for this unbalanced condition, however, is even greater than merely its revival of the 5-year depreciation program on a large-scale basis. In 1954, the administration hammered its thesis that national tax and economic policies generally must emphasize business investment. Among the changes in the tax law, adopted in 1954, were provisions for acceleration of depreciation by all corporations and a grant of special privilege to stockholders to reduce taxes on dividend income. These provisions in the tax laws—coupled with the 5-year depreciation program and its revival in late 1955—have been responsible, in great measure, for the unbalanced flow of investment income and consumption income and for the distorted pattern of growth between investment and consumption in recent years.

A thoroughgoing revision of the Federal tax laws that would emphasize personal consumption is required to bring about a more balanced relationship between investment and consumption.

THE NATIONAL ECONOMY REQUIRES EMPHASIS ON CONSUMPTION

The national economy today is quite different in many ways from what it was in the immediate post-Civil War decades. Those who legislate and administer our tax and economic policies should recognize those changes. Present-day tax and economic policies should be based on the requirements of the American economy in the middle of the 20th century, rather than on the economic conditions of 60 or 90 years ago.

In the past half-century, the American economic system has been changing from the private capital formation centered economy of the last-half of the 19th century to one that is increasingly based on personal consumption and consumer markets. The actual and anticipated level of consumer expenditures for goods, services and housing now provide much of the basis for long-run economic growth.

Consumer markets are an increasingly important motivating force in the national economy. Business investment has been declining from its previous key role in the growth of our economic system. Business investment may have been the key motivating force in the period when the Nation's basic industrial and transportation structure was established. But the growth factors within the national economy have been changing, with changes in technology, the development of mass production and mass distribution, and rising income levels.

In the past 3 to 4 decades, business investment in new plant and equipment has tended to be capital saving, as well as labor saving. A dollar now spent on new plant and equipment tends to return a greater real output than a similar dollar's worth of capital investment, in constant prices, 3 or 4 decades ago.

This important trend has been noted and reported to this committee on previous occasions by representatives of organized labor. It was stated before this committee only last Monday, June 3, by Robert P. Ulin of the McGraw-Hill department of economics. He stated that "although the reported prices of these capital goods have shown rather substantial increases in the past year, the capital goods that are actually being bought are quite different from the older types, and they are much more productive. If we had some way of pricing a capital good in terms of the amount of work it will do, I think the actual cost to the corporation would be quite a lot less. A dollar spent for capital goods in the past year has done a great deal more work than a dollar spent in the previous year."

This trend has been reported in numerous recent studies. These studies indicate that up to approximately World War I, an increasing amount of capital was required to produce an increasing volume of output. Since the World War I period—about 40 years ago—that trend has been reversed. The amount of invested capital per dollar of output has been declining, and it has been declining for some 3 to 4 decades or more.

In his introduction to Daniel Creamer's Capital and Output Trends in Manufacturing Industries, 1880–1948 (National Bureau of Economic Research, 1954), Simon Kuznets states:

"Dr. Creamer's majjor finding concerning trends in the capital output ratio in manufacturing is that a significant rise in this ratio from 1880 to about 1909–19 was followed by a definite and substantial decline to the most recent date studied by him, 1948. Of course, the absolute volume of capital in manufacturing, measured at constant prices, rose throughout the period. But during the first part the relative increase in the volume of capital was greater than in output, so that the capital output ratio rose; after 1909–19, the rise in the volume of capital was significantly lower than that in the volume of output so that the capital output ratio dropped * * *

"* * * this upward movement of the capital-output ratios to the World War I decade and their decline since then are found not only for manufacturing as a whole, but for practically all major industrial subdivisions that can be traced continuously in the available data. The finding is also confirmed whether we deal with total capital or with working capital and fixed capital separately, and for the recent period the decline in the ratio is observed whether we take fixed capital net or gross of accumulated depreciation. The finding is further confirmed with all the possible variations in the denominator: When we take the ratio of capital to gross value of output or to value added in manufacturing."

Creamer's findings are substantiated by other studies. In November 1956, the Department of Commerce publication, Survey of Current Business, reported that in manufacturing industries, between 1929 and 1955, output rose 143 percent, while net plant and equipment increased only 67 percent. If inventories are added to business investment, the trend in manufacturing industries, between 1929 and 1955, is as follows, according to the Department of Commerce: Output rose 143 percent, while investment in plant, equipment, and inventories rose only 77 percent. The Survey of Current Business states: "Capital services per unit of production have also decreased since 1929 for total fixed capital and for structures, irrespective of the capital service measure adopted. * * * The 1955 volume of net capital stock, including inventories, per unit of production was about three-fourths that of 1929."

The declining ratio of business investment to output in manufacturing industries has also been found in mining industries, in a study by Israel Borenstein (Capital and Output Trends in Mining Industries, 1870–1948; National Bureau of Economic Research, 1954).

These findings of studies of manufacturing and mining are borne out in a recent publication of figures for the private sector of the national economy, by the Bureau of Labor Statistics (Post-War Productivity Growth in the United States, Bureau of Labor Statistics, April 1957), based on published data of the Commerce Department and the Machinery and Allied Products Institute. The BLS figures indicate that total fixed capital per dollar of real private product declined 22 percent between 1925–29 and 1955.

As a result of this trend in the national economy, total output has been rising at a more rapid rate than business investment in new plant and equipment. On the average, a dollar of capital investment now produces considerably more output than a similar dollar of capital investment in 1929 or 1919. Another way of putting it is that a smaller share of the Nation's total output is required for business investment in new plant and equipment.

After several long decades of rising productivity of capital investment and the relative decline in the importance of business investment, it is high time that economists generally and those responsible for economic policy decisions face up to the simple reality that much has changed in the American economy since the 1870's and 1880's.

Business investment in new plant and equipment plays an important role in the process of economic growth. That role, however, is of declining relative importance. Technological change, the growth of mass-production industries, of consumer durable goods and consumer services, makes business investment increasingly dependent on the state of consumer markets.

In this type of economy, tax policy and economic policy generally should provide for expanding consumer markets and should emphasize personal consumption. The alternatives to rapidly expanding consumer markets and to a more balanced relationship between investment and consumption are either an acceptance of increasing Government intervention in the economy or of economic stagnation, interspersed with periods of slow growth. Organized labor prefers neither of these alternatives. It prefers to see the solutions worked out primarily in the private sector of the economy. For that reason, among others, the trade unions advocate economic policies that place emphasis upon personal consumption and consumer markets.

A first required step at this time, in terms of tax policy, would be an increase in individual exemptions, under the Federal income tax, from $600 to $700. Such an increase in exemptions would give every taxpaying family a tax cut—not only high-income families or low-income families alone. The distribution of this form of tax relief, however, would be concentrated among low-income and middle-income families—those who need it most and among whom is a vast consumer market for all types of goods and services.

The regressive trend in the Federal tax structure, upon which the unbalanced relationship between consumption and investment rests, should be reversed. An increase in exemptions from $600 to $700 should be viewed as a first step toward restoring a greater degreee of equity to the tax structure and a better balance between investment and consumption. Such a step would mean a Federal revenue loss of about $2.4 billion—a loss that can easily be recaptured by closing some of the loopholes and inequitable provisions in the existing tax structure. Closing those loopholes, furthermore, would provide additional assistance in the urgently required steps to bring about an improved relationship between investment income and consumption income, between business investment in new plant and equipment and personal consumption.

Mr. Goldfinger. Thank you, sir.

National economic activities have been in a lull for 8 months. There have been no sharply rising pressures for goods and services. Changes in the level of economic activities have been largely seasonal.

Industrial production has remained at approximately the same level since last October, after adjusting for seasonal changes. Expenditures for new construction (seasonally adjusted) have been about the same since last July. Retail sales (seasonally adjusted) have remained at about the same level since November. The volume of the Nation's total output of all goods and services was approximately the same in the first quarter of 1957 as in the fourth quarter of 1956. This lull is continuing in the current second quarter of the year.

There are expectations of some pickup in the level of economic activities in the fourth quarter of 1957, after a year of a lull in demand and an increase in the economy's capacity to produce. These expectations are based largely on an anticipation that Government spending will continue to rise and on hopes that the long decline in residential construction is ending, and that the activities on the automobile and related industries will move up after the automobile model changeover. Even if the expected pickup should materialize in the fourth quarter of the year, there is no current sign of anything like a buildup of inflationary demand.

On the basis of the current economic situation and on the basis of foreseeable trends there is no economic justification as far as I can see for the view that vitally needed public programs, such as Government aid for school construction, should be postponed lest they create "inflationary pressures." The lull in the level of national economic activities during the past 8 months indicates rather clearly that the fear of an inflation—that would supposedly arise if the Government attempted to meet some of the public welfare needs of the American people—is without foundation.

This supposed fear of a buildup of inflationary demand, in the face of slipping demand in many industries and a rising capacity to produce, seems to be nothing more than a smokescreen attempt to defeat such measures as school construction, Government aid for distressed areas, extension of the Federal minimum wage to millions of low-paid workers in trades and services, and an expanding housing program. These public programs are based on real social needs and should be considered on their own merits, and not in terms of supposed fears of an inflationary demand buildup which, as I see it, is without foundation in terms of the current economic situation.

Economic developments in the past several years have been characterized by a lack of balance between business investment and personal consumption. Continuation of such an unbalanced condition in the period ahead will undermine the health of our economic system. It was a similar and pronounced lack of balance between investment and consumption during the 1920's that helped to bring on the great depression of the 1930's.

In the 3 years between 1953 and 1956, business expenditures for new plant and equipment rose 23.9 percent. This represents a rise in investment for capital goods and equipment, whose purpose is to increase industry's ability to produce a rising volume of goods and services.

While such investment in new plant and equipment was rising sharply between 1953 and 1956, personal consumption expenditures increased only 10 percent.

This distortion in the growth of our national ecoonmy in recent years can be seen more clearly when we view it in perspective. Plant and equipment outlays were not depressed in 1953, they were not low in relationship to consumption. Indeed, business investment in new plant and equipment has been rising at an extremely sharp rate since 1945.

Between 1945 and 1950, when business attempted to make up for the many depression and war years of low investment, outlays for new plant and equipment rose 13 percent. With the outbreak of the Korean war in 1950, the Government stimulated a further sharp boost in business investment in new plant and equipment, through the 5-year depreciation program. The Government simultaneously followed a policy, after the outbreak of the Korean war, of restraining personal consumption during the national defense buildup through various income and credit regulations. Between 1950 and 1953, investment in new plant and equipment rose an additional 24 percent.

The period following the end of the Korean war and in the peak of the national defense buildup should have seen the development of a new balance between consumption and investment. Such balance, following mid-1953, required policies by private groups and Government to stimulate rising personal consumption.

Instead of emphasis on the growth of personal consumption, there has been an all-out emphasis on stimulating new plant and equipment investment. Instead of a developing balance between investment and consumption, there has been a growing lack of balance between the economy's ability to produce and its ability to consume.

The distortion growth of the national economy in the past 3 years arises from a lopsided flow of spendable cash to the different sectors of our economic system. In the years since 1953, the flow of cash to corporations has risen at a considerably faster rate than personal income.

Between 1953 and 1956, the cash flow to corporations rose 37.7 percent. This sharp rise in 3 years helped to create the basis for the sharp increase in new plant and equipment outlays.

Total after-tax personal incomes, however, increased only 14.6 percent between 1953 and 1956, while the cash flow to corporations was increasing 37.7 percent.

The distortion between investment and consumption between 1953 and 1956, therefore, rested on an unbalanced flow of spendable cash to these two different private sectors of the national economy.

The cash flow to corporations rose 2½ times faster than after-tax personal income between 1953 and 1956. Business outlays for new plant and equipment rose more than twice as fast as personal consumption expenditures in those 3 years.

In November 1950—after the outbreak of the Korean war and the start of the national defense buildup—the Government resumed a policy of granting 5-year depreciation for a wide variety of new plant and equipment, as a means of stimulating large-scale investment and of building a wide defense mobilization base. The 5-year depreciation program continues today, long after the end of the Korean war and long after the peak of the mobilization base buildup. The program declined sharply between mid-1952 and mid-1955. Toward the end of 1955, however, it was revived as a large-scale program. In the fourth quarter of 1955 and the first quarter of 1956, amounts certified for 5-year depreciation rose sharply to levels achieved during the Korean war. This occurred after plant and equipment outlays had already begun to rise sharply and after the rapid depreciation provision of the 1954 tax law changes had gone into effect.

The Government's share of responsibility for this unbalanced condition, however, is even greater. In 1954, the administration hammered its thesis that national tax and economic policies generally must emphasize business investment. Among the changes in the tax law, adopted in 1953, were provisions for acceleration of depreciation by all corporations and a grant of special privilege to stockholders to reduce taxes on dividend income. These provisions in the tax laws—coupled with the 5-year depreciation program and its revival in late 1955—have been responsible in great measure, for the unbalanced flow of investment income and consumption in recent years.

A thoroughgoing revision of the Federal tax laws that would emphasize personal consumption is required to bring about a more balanced relationship between investment and consumption.

In the past 3 to 4 decades, business investment in new plant and equipment has tended to be capital saving, as well as labor saving. A dollar now spent on new plant and equipment tends to return a greater real output than a similar dollar's worth of capital investment, in constant prices, 3 or 4 decades ago.

This important trend has been noted and reported to this committee on previous occasions by representatives of organized labor. It was stated before this committee only last Monday, June 3, by Robert P. Ulin of the McGraw-Hill department of economics. He stated that—

> although the reported prices of these capital goods have shown rather substantial increases in the past year, the capital goods that are actually being bought

are quite different from the older types, and they are much more productive. If we had some way of pricing a capital good in terms of the amount of work it will do, I think the actual cost to the corporation would be quite a lot less. A dollar spent for capital goods in the past year has done a great deal more work than a dollar spent in the previous year.

This trend has been reported in numerous recent studies. These studies indicate that up to approximately World War I, an increasing amount of capital was required to produce an increasing volume of output. Since the World War I period—about 40 years ago—that trend has been reversed. The amount of invested capital per dollar of output has been declining, and it has been declining for some 3 to 4 decades more, and this increase occurred after plant and equipment outlays had already begun to rise sharply.

In this type of economy, tax policy and economic policy generally should provide for expanding consumer markets and should emphasize personal consumption. The alternatives to rapidly expanding consumer markets and to a more balanced relationship between investment and consumption are either an acceptance of increasing Government intervention in the economy or of economic stagnation, interspersed with periods of slow growth. Organized labor prefers neither of these alternatives. It prefers to see the solution worked out primarily in the private sector of the economy. For that reason, among others, the trade unions advocate economic policies that place emphasis upon personal consumption and consumer markets.

A first required step at this time, in terms of tax policy, would be an increase in individual exemptions, under the Federal income tax, from $600 to $700. Such an increase in exemptions would give every taxpaying family a tax cut—not only high income families or low income families alone. The distribution of this form of tax relief, however, would be concentrated among low income and middle income families—those who need it most and among whom is a vast consumer market for all types of goods and services.

An increase in exemptions from $600 to $700 should be viewed as a first step toward restoring a greater degree of equity to the tax structure and a better balance between investment and consumption. Such a step would mean a Federal revenue loss of about $2.4 billion—a loss that can easily be recaptured by closing some of the loopholes and inequitable provisions in the existing tax structure. Closing those loopholes, furthermore, would provide additional assistance, in the urgently required steps to bring about an improved relationship between investment income and consumption income, between business investment in new plant and equipment and personal consumption.

Thank you.

Representative MILLS. Our next panelist is Mr. Roy Battles of the National Grange. Mr. Battles, we are pleased to have you and you are recognized.

STATEMENT OF ROY BATTLES, ASSISTANT TO THE MASTER, THE NATIONAL GRANGE

Mr. BATTLES. Thank you, Mr. Chairman, and I might say that we are delighted also to have the opportunity of coming up here and presenting our viewpoints and comparing notes with the other gentlemen of the panel.

I shall not follow my copy, if it is agreeable with you.
(Mr. Battle's prepared statement follows:)

RECOMMENDATIONS BY THE NATIONAL GRANGE, BY ROY BATTLES, ASSISTANT TO THE MASTER

The National Grange greatly appreciates this opportunity to compare notes with the members of the Subcommitee on Fiscal Policy of the congressional Joint Economic Committee and to participate in a discussion of mutual problems with other panel members.

If agreeable to the members of the committee, I shall deal largely with current problems now faced by the American farmer. In order to deal intelligently with these problems, one must recognize the following characteristics of the agricultural industry:

1. We have a wise national agricultural policy of abundance, which accounts for the fact that total supplies of food and fiber are almost always somewhat in excess of demand. Also due to this policy of abundance, there are year-in and year-out carryovers. Inherent in this imbalance between supply and demand are price and income problems for producers.

2. We have failed to develop satisfactory insulating techniques to prevent annual carryovers of farm commodities from depressing prices. Often a small annual surplus in production plus the annual carryover tends to set the price on the entire output.

3. There are indications that the capacity of the American farmer to produce will continue to exceed available markets, at anywhere near break-even farm prices, for at least several years. This is true despite our population explosion, higher levels of consumer consumption, increased industrial uses of farm commodities and some expansion in foreign food and fiber outlets. Elasticity of demand for food is limited far more than it is for many other consumer items. As income rises, a family may own two cars, but seldom does it eat twice as much hamburger. Food is also often a residual item in the family budget of the low-income family.

4. Present efforts to curtail production of specific farm commodities, for the most part, are loaded with undesirable and unworkable features. Only partially have they been successful. It is almost a universally conceded fact that they are not the complete and ultimate answer to balancing supplies with demand.

5. Even though they may not be the complete answer, expanded markets are a far sounder solution to the problem.

6. Farmers are victims of a vicious cost-price squeeze, of which this committee is fully aware. Net farm income (the income to all farmers after paying production expenses) has declined from 1951 to date from $16.1 to $15.1 to $13.3 to $12.5 to $11.7 to $11.6 billion in 1956 (these figures include net change in inventories). Any way one looks at it, farmers are not sharing in the Nation's prosperity. Their plight is a major national problem.

It is because of this problem that we welcome the opportunity to make some broad general comments and recommendations in the realm of governmental fiscal and general policy for the consideration of this committee.

1. Not only is it fair, right and desirable that farmers and those who depend upon the purchasing power of farmers enjoy a level of living comparable with others of equal skills and ability, investments, risks and labor input; it is imperative from the national viewpoint if this great and important segment of our economy is to make continuing contributions to the total national economic welfare.

2. Few other segments of the economy operate in an economically pure climate of full, all-out production, coupled with a market entirely free of escalators and mechanisms devised to protect those involved from the forces of competition. To varying degrees, these mechanisms, used to eliminate the effect of full, all-out competition, are fostered or condoned by Government as being in the public interest. The Federal ICC near monopoly in setting transportation rates is only one of several examples. This is the economic climate in which the cost of farm supplies is determined. Except for a few special crops and commodities, agriculture operates with nearly 5 million farmers in full competition with each other. The problem multiplies due to the fact that in the case of many farm commodities, lower prices result in increased production with little increase in consumption. Farmers cannot be expected to operate under one system while the rest of the economy operates, to varying degrees, under another. This is the heart of the cost-price squeeze; something which

even farmer cooperatives cannot fully offset, since they must contend with the same forces as other businesses.

Our recommendations, then, to industry, labor, the professions, and Government in this field are twofold:

First. All must exercise great restraint in the creation and use of devices designed for the protection, insulation, freezing, or the hampering of economic functions of price and competition, wages related to productivity, including the law of supply and demand. Our concern must be for the total public interest. Government and this committee have an obligation of paramount importance in this field.

Second. For the time being at least, agriculture must rely upon some of the same implements and techniques used by others to raise prices, wages, and income. As an industry, we must call upon Government, not to do the job for farmers, but to provide them with the self-help mechanisms necessary to do the job for themselves.

The farm problem is a many-sided one and requires multiple answers. The current belief in some quarters that all that is necessary is to continue to lower farm prices and the farm problem will automatically solve itself is completely fallacious. We agree that people must leave the land (they are leaving the land and will continue to leave the land), but to expect to speed up materially this relocation of human resources by continually lowering farm prices is to bankrupt a major portion of rural America in the process.

3. In the process of helping farmers to help themselves, however, it would be unwise to destroy the function of price and competition in the food and fiber market place, particularly in relation to resource allocation (the freedom of interplay between farm enterprises in accordance with buyer preference, both here and abroad, as well as other factors, rather than to accomplish production shifts by Government edict).

Our philosophy is predicated on a faith in the incentive system; on a belief that competitive private marketing operations will do the best possible job of market expansion, sales promotion, and efficient distribution. We believe that to follow continually a philosophy of virtual Government price fixing through the present horizontal price-support program is to interfere with and ultimately destroy private marketing operations, and to depress rather than to improve the income of American farmers.

This has led the National Grange to seek a new approach to a solution of the problems in agriculture. We recommend a relatively free-market operation for food and fiber, both in the production and marketing end of the business, coupled with devices specifically aimed at raising farm income by specific devices to fit each commodity. Income, however, would be supported only on that portion of the production moving into the primary American market, where farmers must pay an American price for their production supplies. Farmers do not expect this sort of income protection for that portion of their production that moves into world or secondary markets, but they do expect the right to produce for those markets at a free market, or world price, if they so desire. This is called the domestic parity approach.

In the case of several export crops, the device used to provide an American income for that portion of a producer's production used in the United States primary market is an income payment. The money for these payments would come not from the taxpayer, but from the consumer of those products in proportion to the volume of consumption. The function of the Government would be to provide the mechanism and to set up general rules that would protect the public interest. There are other commodity-by-commodity devices that will accomplish the same thing, but I merely desire to pose the idea here.

Finally, we would like the committee to know that in the broad general field of national economic, fiscal and monetary policy, we have these opinions:

1. The American farmer has a major stake in a continuing high degree of national prosperity, employment, and buying power. To him, this means markets.

2. Rural people have a paramount interest in a type of United States foreign policy that leads not only to peace, but also to the gradual creation of jobs and buying power in foreign lands, accompanied by mutually advantageous international trade, which would provide United States farmers with an opportunity to compete for world markets without Government subsidy.

3. Expanded programs of agricultural research and education, in the interest of efficiency in production and marketing as well as in the interest of increased

utilization of farm products, is a tremendously profitable public investment which benefits bountifully both farmers and consumers.

4. Whether or not federally generated fiscal and monetary policies are sufficient to hold inflation in check, we do not know. We are, however, certain that anything more than very gradual price rises amounts to sheer robbery for a major segment of our citizenry. We notice, furthermore, that the curve of wholesale prices, after rising for over a year, is now gradually leveling out. We urge the committee to explore the part that the continuing wage-price spiral plays in rising prices and inflation. It seems to us that we are involved in a vicious circle that can only lead to steadily rising farm costs.

Farmers realize full well that it is better to pay higher interest rates on borrowed capital than it is to suffer greater costs through higher inflationary prices of farm supplies.

It should be pointed out, also, that, in providing credit to farmers at the lowest possible rates, consistent with the credit market and under terms of repayment that are thoroughly geared to the peculiar nature of the farming business, the farmer-owned cooperative credit agencies under the Farm Credit Administration serve an essential pattern-setting function.

The Farmers' Home Administration, furthermore, serves well the public interest in helping family farmers to secure capital for sound purposes in cases where this capital is not available from other sources.

5. The Grange believes that production and employment, paid for with buying power sapped from the taxpayer without resulting in consumer goods and services, is often a national waste. We, therefore, recommend that, wherever Federal expenses can be pared without endangering the national security or welfare, this be done, thus enabling tax cuts to be made, which in turn would result in added investment and buying power on the part of consumers. We believe that a substantial cut in Federal spending, accompanied by a corresponding cut in taxes, would not bring into play any substantial increase in inflationary pressures.

To operate in the red, however, at the Federal level of government, at this time of high national prosperity, is unthinkable. Now is the time, it seems to us, to lower the Federal debt.

Mr. Battles. I shall comment briefly. I will try not to run over the 5- to 7-minute limit.

First of all, I have four points that I would like to make with respect to the position of the American farmer at the present time as it relates to fiscal and monetary policies.

No. 1 is that the American farmer has a high stake, as you can well recognize, in a continuing high degree of national prosperity, employment, and buying power. To him, this means markets.

Secondly, while this doesn't deal directly with the immediate fiscal and monetary policies of our domestic economy, it does have an important bearing in rural America. Rural people have a paramount interest in the type of United States foreign policy that leads not only to peace, but also to the gradual creation of jobs and buying power in foreign lands, accompanied by mutually advantageous international trade, which would provide the United States farmers with an opportunity to compete for world markets without governmental subsidy.

Third, whether or not fiscal Federal policy and monetary policy are sufficient to hold inflation in check, we do not know. We are, however, certain that anything more than a very gradual rise in prices amounts to sheer robbery for a major segment of our citizenry. We notice, furthermore, that the curve of wholesale prices, after rising for over a year is now gradually leveling out. We urge the committee to explore the part that the continuing wage-price spiral plays in rising prices and inflation. It seems to us that we are involved in a vicious circle here that can only lead to steadily rising farm costs.

The farmer realizes full well, also, that it is better to pay higher interest rates on borrowed capital than it is to suffer greater costs through higher inflationary prices of farm supplies.

Lastly, the National Grange believes that production and employment, paid for with buying power sapped from the taxpayer without resulting in consumer goods and services, is often a national waste. Therefore, we recommend that, wherever Federal expenses can be pared without endangering the national security or our national welfare, this be done, thus enabling tax cuts to be made, which in turn would result in added investment and buying power on the part of the consumers. We believe that a substantial cut in Federal spending, accompanied by a corresponding cut in taxes, eventually would not bring into play any substantial increase in inflationary pressures. To operate in the red at the Federal level, however, at this time of high national prosperity, is unthinkable. We think that now is the time to lower the Federal debt to some degree.

We think, in agriculture, that we are faced with a peculiar situation that few other segments of the economy are faced with. First of all, we have a wise national policy of abundance. Abundance, Mr. Chairman, means annual carryovers, and it means always a supply of a total greater than the demand. That is bound to lead to problems.

Furthermore, we have not, in agriculture, developed insulating techniques which enable us to insulate this market-depressing force.

Thirdly, we have attempted to curtail production of our commodities in the same way as the first gentlemen stated that the motor industry and other segments of the economy have cut down on production to meet the demand that is apparent at the time.

I think, while this effort has had some value, basically it has failed, and we must look for other ways of getting ourselves in balance, with supply and demand, and the total that is agriculture. Our problem is that we do not have a small number of producers producing food and fiber. We have 5 million of them. There is great difficulty in attaining balance between supply and demand, either through gradually lowering prices to discourage production and increase consumption, or to attain balance in supply and demand by regulation by Federal edict. Basically we find ourselves in that position with respect to our income side of the ledger. We feel, also, that we must work for added markets. This is a better answer than to have the production-curtailment efforts.

Coming now to this matter of farm costs, we are in a real cost-price squeeze, which this committee and all members of the panel, I think, well recognize. Net farm income, the income to all farmers after paying production expenses, has declined since 1951 consistently as follows: $16.1 billion, $15.1 billion, $13.5 billion, $12.5 billion, $11.7 billion, $11.6 billion, and that is the 1956 figure, and these figures include inventory changes. So, any way one looks at it, the farmer is not contributing his fall all-out possible contribution to the total welfare at this time. Not only is this limited to farmers, but also to that segment of the economy which depends upon farm buying power to make its contribution to national welfare and to national prosperity.

Basically, in this matter of coping with the cost-price squeeze it is our feeling that few other segments of the economy operate in an economically pure climate of full all-out production, coupled with a market entirely free of escalators and mechanisms devised to protect those involved from the forces of competition. To varying degrees these mechanisms used are used to eliminate the full effect of all-out competition and are fostered or condoned by the Government as being in the public interest. At least they are fostered and condoned. The Federal ICC (the Interstate Commerce Commission) operating a near monopoly in setting transportation rates, is only one of several examples. This is the economic climate in which the cost of farm supplies is determined. Except for a few specialized crops and commodities, agriculture operates with nearly 5 million farmers in full competition with each other. The problem multiplies due to the fact that in the case of many farm commodities lower prices result in increased production with little increase in consumption.

Farmers cannot be expected in our opinion to operate under one system while the rest of the economy operates under another. To varying degrees at least that is true. This is the heart of the cost-price squeeze, something that even farmer cooperatives cannot fully offset, since they must contend with the same forces as other business.

Our recommendations then to industry, labor, the professions and Government in this field are twofold: First, that we exercise great care in creating and using devices designed for the protection, or insulation or freezing, or hampering of the economic functions of price and competition, wages related to productivity, and this includes of course the law of supply and demand. Our concern must be for the total public interest, and Government and this committee must be obligated to take major and paramount cognizance of the importance of this field.

Secondly, for the time being at least we feel in agriculture that we may have to rely on some of the same implements and techniques used by other groups to raise prices and wages and income.

As an industry we must call upon Government not to do the job for us, but to help us with self-help mechanisms to get this job done.

In summary, Mr. Chairman, what I am saying in the field of monetary policy and fiscal policy is that so long as one segment of the economy operates somewhat in one area, under one system, with built-in mechanisms and escalators, and we operate with 5 million out in the open pretty fully competing with each other, not able to curtail production and not able to expand markets to fully absorb that production, we are in grave trouble. So we say in essence that we hope that labor, industry, the professions and Government will exercise controls in those areas which have to do with our costs, and secondly, that we may have to buy some of the techniques that these gentlemen use here to insulate themselves at least to varying degrees from the full, all-out effect of the competition.

Thank you very much.

Representative MILLS. Thank you, sir.

Our next witness is Mr. W. E. Hamilton, director of research, American Farm Bureau Federation.

Mr. Hamilton, we are pleased to have you and you are recognized.

STATEMENT OF W. E. HAMILTON, DIRECTOR OF RESEARCH, AMERICAN FARM BUREAU FEDERATION

Mr. HAMILTON. Thank you, Mr. Chairman.

I am W. E. Hamilton, director of research for the American Farm Bureau Federation. We also apreciate this opportunity to summarize our views on some of the important questions before this committee.

Our members have long felt that many of the most important things affecting the welfare of farmers lie outside the area of what are commonly referred to as farm policies. The policies followed by the Government on monetary and fiscal matters are among the most important of these outside influences.

In our view, the prime objectives of monetary and fiscal policy should be the maintenance of a relatively stable general price level and the creation of a favorable climate for economic growth and a rising standard of living. When we speak of the desirability of maintaining a relatively stable price level, we are really talking about stabilizing the purchasing power of the dollar. We are not proposing that individual prices be fixed or regulated. On the contrary, we are strongly opposed to direct price and wage controls.

It is generally recognized that deflation is bad for the economy. This is particularly true in the case of farming because it is a well-known fact that farm prices tend to fall more than farm costs in a deflationary period. It is not so generally recognized, but nonetheless true, that inflation also is bad for the economy in the long run. If supplies of farm products were in a reasonable balance with market demands, farmers might well obtain a temporary advantage from inflation. Under present conditions, however, when we have large surpluses of many important farm commodities, inflation would intensify the cost-price squeeze on farmers. In other words, existing surpluses would act as a brake on the prices of some farm commodities, even in an inflationary situation, but there is no such restraint on the prices of the industrial goods farmers buy.

The most serious objection to inflation, however, probably is the fact that a continuing decline in the purchasing power of money tends to create unstable conditions and thereby set the stage for an eventual deflation. Our worst depressions have followed periods of inflation and there is no question but what effective action to prevent inflation would go a long way toward preventing serious depressions.

Government policies which affect the supply of money and credit—and consequently the value of money—should be directed toward promoting a relatively stable general price level together with high employment and rising productivity.

Such policies include those of the Federal Reserve System and the Treasury's debt management division as well as Federal tax, lending, and spending policies. The Government also has a responsibility to so conduct its affairs as to inspire confidence that everything possible is being done and will be done to maintain sound money and protect the economy from the extremes of inflation and deflation. This is vital because when people believe that either inflation or deflation are likely to take place, they may well take actions that will help it cause the expected trend to develop.

We strongly believe that the present independent status of the Federal Reserve System should be continued and that the system should relate its policies to the country's needs for money and credit rather than to other considerations such as the cost of carrying the national debt. It is not our purpose to defend individual Federal Reserve decisions. Our point is that the Federal Reserve System should endeavor to make a maximum contribution to the prevention of both inflation and deflation and that it should be free to do so. The fact that the Federal Reserve and the Treasury Department sometimes disagree on policy should disturb no one. Such disagreements provide a means of focusing public attention on the issues that are involved in monetary policy and thus act as one of the checks and balances that are essential to the successful operation of our system of Government.

Government tax policies should be designed not only to bring about a fair and equitable distribution of the tax burden, but also with due regard to their effects on the national economy. In order to contribute to a stable price level, tax revenues should rise relative to Government expenditures in inflationary periods and fall in depression. Our present tax system helps to accomplish this to a considerable degree, but of course you have to work on it from the expenditure side also.

Long range plans should be made for the gradual reduction of the national debt, however, debt retirement should be handled so as to contribute to the stability of the general price level and an expanding economy. Debt reduction should be given priority over tax reduction except in periods of national emergency or threatened depression.

When the budget recommendations were presented to the Congress in January 1957, Farm Bureau was disappointed that increased spending was recommended for the 1958 fiscal year. We do not feel that the 1958 Federal budget is consistent with the principles of (1) strict discipline over expenditures and (2) administration of the Government's financial affairs in such a way as to help stabilize the economy and encourage its sound growth, which the President's Economic Report referred to as fundamentals of Government budget policy.

In our opinion, Federal spending on the scale proposed will have an inflationary effect on the economy even though the budget does show a slight surplus, and recent reports indicate that any surplus may be "slight" indeed. We feel, therefore, that from the standpoint of economic stability the budget should be cut and payments on the national debt increased substantially during fiscal 1958. It is our hope that the budget can be reduced and our fiscal policies managed in such a way as to permit both an orderly reduction in the national debt and an early tax cut. We believe that the objective should be a reduction of approximately $6 billion in the appropriations recommended by the budget for 1958. To achieve this goal it will be necessary for Congress to insist on the elimination of all nonessential expenditures and the deferral of all except the most urgent new programs. We hope that Congress will carry through on its apparent determination to reduce Federal spending.

Over the years the Farm Bureau has developed a long-range tax policy which includes the following major points:

(1) The personal income tax should be the major source of Federal revenue. Its base should be kept as broad as practicable through the

retention of reasonably low exemptions. All self-supporting persons should make a direct contribution to the support of the Government.

When conditions warrant a reduction in the personal income tax, rate reductions—particularly in the lower brackets—should have priority over proposals which would take substantial numbers of taxpayers off the rolls. We do not think it would be sound to set the exemptions so high as to create a large class of people who pay no direct Federal taxes and who, consequently, feel that anything they can get from the Government will be costless.

(2) A general Federal sales tax should be avoided. Such a tax would create inequities, increase production costs, and further increase the overlapping of Federal and State tax systems. The retail sales-tax field should be left to the States. As a long-range tax policy, Federal excise taxation should be limited largely to nonessential and luxury goods. As a step in this direction, existing excise taxes which affect agricultural production and distribution costs should be eliminated. Such taxes include the excise taxes on transportation of property, lubricating oil, farm-tractor tires, and a number of other items.

(3) We support the principles of the tax law which provide (*a*) that cooperative savings allocated to member patrons are taxable in the hands of such patrons where the obligation to the patron is certain, and (*b*) that the savings held by cooperatives in the form of unassigned surpluses are taxable in the same manner as the profits of other corporations. We recognize, however, that some revision of the law may be necessary to clarify its application to specific cases.

(4) Industries based on the extraction of exhaustible resources should be allowed reasonable depletion allowances. We are not prepared to say what is "reasonable" in this connection; however, we have some questions about the justification for depletion allowances that permit a taxpayer to recover his invested capital tax free several times over. It is to be noted that those who defend the present oil and gas depletion allowances usually base their case on the "need" to encourage exploration and development rather than on the grounds of equity in taxation.

(5) The treatment of capital gains under the Tax Code should avoid unduly discouraging the investment of risk capital without creating a loophole. The present minimum holding period requirement for capital gains treatment should be continued, but the capital gains tax rate should be reduced as the time the asset has been held increases, provided adequate safeguards can be developed to prevent abuses. We have a very direct interest in this in agriculture.

In fact this recommendation is very important from the standpoint of agriculture—particularly in an inflationary period. At the present time, the sale of a farm often results in a capital gain for tax purposes where much of the so-called gain merely reflects the decreased purchasing power of money rather than a real profit.

(6) The accelerated amortization program under which the Government has allowed industry a rapid tax writeoff on part, or all, of the cost of certain new facilities has outlived any justification that it may have had in the Korean emergency, and should be terminated.

(7) The Federal Government should declare a definite policy with regard to replacing taxes lost to local governments through the acquisition of property by the National Government.

(8) Federally owned enterprises used for the commercial production of commodities or services that normally are supplied by private enterprises should be subject to payments in lieu of taxes including Federal income taxes in amounts comparable to the taxes levied on similar privately owned property or income.

This would eliminate an advantage Government-owned businesses have over private enterprise and would make it much easier for taxpayers to compare the operating results of publicly and privately owned business operations.

(9) Income from all future State and local government bonds issued to finance commercial ventures normally carried on by private enterprise should be taxed as other income is taxed.

(10) Congress should provide additional methods of equalizing the tax burden on widely fluctuating individual incomes where the problem arises primarily from causes beyond the control of those affected. The weather hazard is one example of why farmers need additional consideration in this regard.

The attached resolutions adopted by the elected voting delegates of our member State farm bureaus at our last annual convention contain a more detailed statement of our views on monetary and tax policies.

Representative MILLS. Thank you, sir.

The resolutions will be placed in the record.

(The resolutions referred to follow:)

MONETARY AND TAX POLICIES

Price level stability

We reaffirm our belief in the importance of measures to bring about a more stable general price level as a means of providing a favorable climate for economic growth and a rising standard of living. This is essential if we are to avoid a far-reaching expansion of Government controls over individual decisions and actions.

We continue to oppose direct price and wage controls.

We recognize that a stable price level does not automatically insure satisfactory economic conditions in individual industries. It will, however, be easier to solve the problems of individual industries, including agriculture, if we can avoid the disruptions of inflation and deflation.

Many things—including the policies followed by industry, labor, and agriculture—affect the general price level. The Government has particularly important responsibilities in this field. The Constitution provides that Congress shall have power to coin money and regulate its value. Furthermore, the Government's financial operations are so large that they affect the course of the general price level. Government policies which affect the supply of money and credit should be directed toward promoting a relatively stable general price level together with high employment and rising productivity. The Government also has a responsibility to so conduct its affairs as to inspire confidence that everything possible is being done to maintain sound money and protect the economy from the extremes of inflation and deflation.

In periods of relatively high employment and business activity, the Federal Government should balance its budget and keep it balanced to eliminate the need for deficit financing. If the budget is unbalanced in such a period, the Government should borrow necessary funds from nonbank lenders to the maximum extent possible to avoid the creation of new money. The existing national debt should be managed to prevent non-bank-held securities from being shifted to the commercial banks, as such a shift creates new money just as the sale of new securities to banks.

In periods of declining employment and falling prices, these policies can be reversed to combat deflation. In such a period, for example, it may be desirable to reduce taxes to leave more purchasing power in the hands of the public even though this results in a deficit.

If the budget is to be unbalanced to counteract a deflationary trend, emphasis should be on reduced taxes rather than increased Government spending.

The Federal Reserve System alone cannot insure a stable price level. It can help, however, by relating its policies to the country's needs for money and credit rather than to other considerations. The independent status of the Federal Reserve Board must be maintained.

The Federal Reserve Board should restrain the expansion of bank credit in inflationary periods and make it easier for the banks to extend credit if deflation threatens. When inflationary pressures make it necesesary to restrain credit expansion, the use of credit to expand production rather than consumption should be emphasized. When deflation threatens, the emphasis should be on increasing consumption.

Undue restriction of agricultural credit should be avoided during the present period of adjustment.

The policies of Government agencies which make or guarantee loans should be coordinated with overall credit policies.

In order to be effective in checking deflation, the Federal Reserve System must recognize the danger of a downturn and act before deflation has gone so far that public confidence in the outlook is undermined. In such a situation, prompt tax rate reductions, especially in the lower income brackets, can be a valuable supplement to Federal Reserve action. It is generally recognized that it is more difficult to combat deflation than inflation with monetary and fiscal policies. It should be remembered, however, that our worst deflations have followed periods of inflation and that effective action to prevent inflation will go a long way toward preventing subsequent serious depressions.

We urge that the American Farm Bureau Federation board of directors continue to sponsor periodic conferences on monetary and fiscal policy.

Long-range tax policy

A sound national tax policy is necessary to maintain the private enterprise system, which is the foundation of our form of government. Tax programs should be designed not only to bring about fair and equitable distribution of the tax burden, but also with due regard to their effects on the national economy.

As a long-time tax policy, we favor the following principles and urge their adoption as rapidly as conditions permit:

(1) Long-range plans should be made for the gradual reduction of the national debt; however, debt retirement should be handled so as to contribute to the stability of the general price level and an expanding economy.

Debt reduction should be given priority over tax reduction in periods of national emergency or threatened depression.

(2) A Federal tax policy should be adopted which will contribute to a stable price level in an expanding economy. This means that tax revenues should rise relative to Government expenditures in inflation and fall in depression.

(3) The personal income tax should be the major source of revenue for the Federal Government. Its base should be kept as broad as practicable through the retention of reasonably low exemptions. All self-supporting persons should make a direct contribution to the support of government. When conditions warrant a reduction in personal income taxes, rate reductions—particularly in the lower brackets—should have priority over proposals which would take substantial numbers of taxpayers off the rolls.

(4) We favor gradual reduction and eventual elimination of hidden taxes.

(5) Taxes levied to increase revenues in an emergency should be terminated when the emergency has passed.

Federal excise and sales taxes

A general Federal sales tax should be avoided. Such a tax would create inequities, increase production costs, and further increase the overlapping of Federal and State tax systems. The retail sales tax field should be reserved to the States.

Existing excise taxes which affect agricultural production and distribution costs should be eliminated. Federal excise taxation should be limited largely to taxes on nonessential and luxury goods. All purchasers of items on which an excise has been paid should be informed of the amount of such taxes.

Taxation of cooperatives and corporations

We continue to oppose aggressively any efforts to tax cooperatives on savings which are returned to the member patrons in such a form as to be taxable in their hands. We support the principles (1) that cooperative savings allocated to member patrons are taxable in the hands of such patrons where the obligation to the patron is certain, and (2) that savings held by cooperatives in the form of unassigned surpluses are taxable in the same manner as the profits of other corporations. These principles constitute a great safeguard to the interests of true cooperatives. We recognize, however, that some revision of the law may be necessary to clarify its application to specific cases.

All corporations should be exempted from Federal income taxes on earnings distributed to stockholders as dividends and taxable in the hands of the stockholders.

We oppose the application of a withholding tax to the dividends of corporations, including cooperatives.

Depletion allowances

We support the principle that industries based on the extraction of exhaustible resources should be allowed reasonable depletion allowances.

Capital gains

The treatment of capital gains under the tax code should avoid undue discouragement of the investment of risk capital without creating a tax loophole.

We recommend continuation of the minimum holding period provided by present law for capital gains treatment. We also recommend that the rate of tax on capital gains be reduced as the length of the holding period increases, provided adequate safeguards can be developed to prevent abuse.

Accelerated amortization

We urge termination of the accelerated amortization program, under which the Government has allowed industry a rapid tax writeoff on part or all of the cost of new facilities. As a long-time policy, any encouragement that may be found to be necessary to bring about the construction of new facilities should be provided through generally applicable provisions of law rather than by programs which require that the Government pass on individual projects.

Federally owned property

The Federal Government should declare a definite policy with regard to replacing taxes lost to local governments through the acquisition of property by the national Government.

Federally owned property which is used to produce for sale commodities or services that normally are supplied by private enterprise, should be subject to payments in lieu of taxes, including Federal income taxes, in amounts comparable to the taxes levied on similar privately owned property and income.

Property acquired by the Federal Government, even though it does not compete with private enterprise, often diminishes the tax base of local government. The Federal Government should compensate for the tax loss thus caused to local taxing units where such action on the part of the Government does not correspondingly reduce the expenses of the local taxing unit.

In any school district or county where tax exempt Indian lands are located, the Federal Government should make payments in lieu of taxes in amounts comparable to the taxes paid on other real estate.

Other tax problems

Income from all future State and local government bonds issued to finance commercial ventures normally carried on by private enterprise should be taxed as other income is taxed.

We favor an amendment to the Federal income tax law to permit the deduction of premiums paid for hospital and medical insurance on the same basis as business expenses.

Congress should provide additional methods for equalizing tax burdens on widely fluctuating individual incomes where the problem arises primarily from causes beyond the control of those affected.

Present requirements for the payment of estate taxes frequently work a hardship on heirs by forcing liquidation of assets, such as farm land, at less than their real value. We recommend that Congress authorize the payment of Federal estate taxes in installments over a reasonable period.

Representative MILLS. Our next panelist is Mr. John A. Baker, of the National Farmers Union. Mr. Baker, we are pleased to have you with us, and you are recognized.

STATEMENT OF JOHN A. BAKER, COORDINATOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

Mr. BAKER. Thank you, Mr. Chairman. I appreciate, myself, and our organization does, the efforts that this subcommittee have made to hold these extended hearings. I would also like to say for the record, Mr. Chairman, that being from Arkansas I think I can say that the people of Arkansas are very proud of the chairman of this subcommittee.

Representative MILLS. Thank you, Mr. Baker.

Mr. BAKER. The Treasury of the United States Government has lost over a billion dollars in unnecessary expenditures during the past 4 years owing to faulty farm policy. Only last week the Secretary of Agriculture recommended to Congress another, what he calls, logical step, in the same disastrous direction. Farm-family incomes have dropped by a billion dollars a year while he has been in office, and to complete the record that Mr. Battles just recited of the year-by-year drop in farm income, over the 5 years it has been a continuous fall amounting to 30 percent.

Yet those faulty farm policies have increased net budget expenditures from $800 million a year to over $5 billion per year. As a general farm organization our primary specific interest, of course, is the promotion of policies that will enable farm people to move toward a parity of income in a general economy that is providing ever greater economic opportunities to all. We are convinced that attainment of parity farm income is consistent with and part of the general public interest.

Our national economic growth, in real terms, is grinding to a standstill, as reports of your committee and of the President's Council of Economic Advisers reveal. This is true despite a still rapid increase in population numbers and of output per man-hour. The result shows up in falling farm income, reduced working hours that mask the rise in partial unemployment, and the generally worsened conditions of those in our economy whose bargaining positions are weakest and whose positions are most vulnerable. To make matters worse, this growing economic stagnation is largely masked from public view by the insidious inflation of administered industrial wholesale prices, by governmentally decreed doubling of interest rates, by inflation of administered retail prices, and the continued rise in administered service charges.

Output per man-hour in farming continues to increase more rapidly than in the rest of the economy. The increase is much more rapid than the continued increase in population numbers. This situation means a continuous depressing effect on farm prices and farm income. To help reduce these chronically disadvantaging effects, farmers have a direct interest in fiscal and other policies that will promote national economic growth at the maximum attainable rate. Such policies increase the demand for farm commodities and provide desirable off-farm employment opportunities for the otherwise underemployed in rural areas. If the existing price structure can be realined and balanced up, we believe that subsequently general price stability is to be preferred to either inflation or deflation.

The current economic situation is one of unbalance, not of general inflation. We believe that a large part of the unbalance has been promoted by national economic policies of the Federal Government and can be corrected by appropriate changes therein.

We are convinced that a first policy in the correct direction is the inauguration and expansion of Federal programs and appropriations needed to meet our great national priority needs for public investments such as defense, international economic cooperation, schools, housing, highways, and resource development.

In addition we must make sure that our national economic policies promote a rapid enough expansion of consumers' incomes that they will be able to buy the increasing volume of output made possible by expanded plant capacity, an expanding labor force, and increasing productivity. These policies we believe to be consistent, in the current and prospective economic situation, with a balanced budget, and an early increase in the personal income-tax exemption. Under the circumstances, we do not believe that general tax reduction would be wise fiscal policy. Rather we suggest that what is needed now is an upward adjustment in the personal exemption and a closing of tax loopholes that would provide enough revenue to more than make up for the increase in personal exemptions.

The national economy is developing many serious imbalances; some incomes and prices are dropping; others are increasing too rapidly. Federal expenditures are kept in balance with a faulty revenue structure only because national priorities fundamental to sustained economic growth are being postponed or disregarded. What is required, in our view, is a balancing up, both of the economy generally and of our national fiscal policies. To allow the unbalances to continue and get worse would be not only to violate all considerations of fairness and equity but also to run the grave danger of sewing the seeds of national depression.

Farmers require the right to use a great many additional devices of the type, too, Mr. Battles mentioned, to improve their bargaining position in the commodity and money markets of the Nation and of the world. But getting or using these devices would be more difficult and less effective in a stagnant or depressed economy than in an economy that is expanding at the maximum possible rate consistent with balanced general price stability.

Establishment of intelligent Federal farm policies that will enable farmers to move toward a parity of income through greater bargaining strength will not only reduce the drain on the Treasury that has accompanied the faulty farm policies of the past 4½ years but will also increase Federal revenue receipts as more and more farm families reach the enviable position where they will earn enough income to be eligible to make greater contributions to the Treasury.

Adoption of good farm policy would make a significant contribution to better fiscal policy as we told the Appropriations Committees this year: "Faulty farm policy means bad budget policy." We again strongly urge, as we did those committees, that while these faults probably cannot now be fully corrected for application in the 1957 crop year, such as additional action of the kind that the House took with respect to the acreage reserve the other day, it is surely not yet too late to reverse these adverse trends for the 1958 crop year. The same can also accurately be said of our taxation and expenditure policies and of the debilitating monetary policy that is now being followed.

Thank you, Mr. Chairman.

Representative MILLS. Thank you, Mr. Baker.

Our next panelist is Mr. Miles Pennybacker, president of the Voltarc Tubes, Inc., representing the Independent and Small Business Coordinating Committee, Inc.

Mr. Pennybacker, we are pleased to have you with us this morning and you are recognized.

STATEMENT OF MILES PENNYBACKER, REPRESENTING INDEPENDENT AND SMALL BUSINESS COORDINATING COMMITTEE

Mr. PENNYBACKER. Thank you, Mr. Chairman, I appreciate the invitation to appear here. I would like to say that the admiration which Mr. Baker expressed is not limited to the people of Arkansas. I can speak for the people of Connecticut, also, in saying that we greatly appreciate the especially able manner in which you handle the chairmanship of this subcommittee. I am sure this goes for other States as well.

Representative MILLS. Thank you, sir.

Mr. PENNYBACKER. I am here as a representative of the Independent and Small Business Coordinating Committee. I am president and owner of a small manufacturing company, Voltarc Tubes, Inc., of Norwalk, Conn. We manufacture fluorescent lamps, and products that are used in electric signs.

My statement may be summarized in outline form as follows:

I. Recent trends show some serious soft spots in the economy.

II. Moderate remedial fiscal action now is indicated:

(*a*) Modify the corporate income tax to shift some of the burden from small to large corporations.

(*b*) Reduce taxes on low-income individuals.

III. The possibility of further adverse trends should not be neglected in fiscal planning.

IV. Compensatory spending, and standby tax reductions:

(*a*) Projects that warrant large Government spending should be planned now.

(*b*) The Congress should grant to the President certain standby powers to lower taxes as warranted by economic conditions.

The following will supplement the above outline:

I. RECENT TRENDS

Small businesses, and small manufacturers in particular, are now in a period of recession. During the past 4 years of prosperity for big business many thousands of small manufacturers have failed, and the total number of manufacturers has declined. Total failure liabilities in dollars were higher in 1956 than for many years past, they have averaged still higher in 1957. Average small-business profits as a percentage of sales continue to be very low, compared to those of big business. The inequitable results of credit tightening have further restricted small-business activity.

93528—57——16

In spite of increases in consumer credit, consumers have by no means been able to increase their purchases to match the increases in our productive capacity. Housing, automobiles, appliances, textiles, and agriculture are some of the important suppliers to consumers that have slowed down. Consumers have not yet felt the full brunt of the price increases that have in general started with big business and have been absorbed partially by small business. Consumer purchasing power must grow much faster than it has recently if we are to keep employed our growing labor force, with its increasing productivity, and if we are to utilize the enormous expansion of plant capacity that has taken place in 1955, 1956, and 1957. Big business profits based to a considerable extent on price increases in those fields of limited competition where administered prices are possible, have stimulated capital investment. This investment (in producers' equipment) grew 8 times as fast as the increase in consumption from the fourth quarter of 1955 to the fourth quarter of 1956.

II. REMEDIAL ACTION

A very substantial reduction in the tax on small corporate income, with a change for large corporate incomes from the present 52-percent maximum to a maximum rate of 53 percent, is recommended. This could be done with no decrease in Federal revenue. It would enable small business to compete more effectively, and hence would tend to eliminate artificially high administered prices.

A reduction in individual income tax in the low brackets is a desirable step to correct the growing imbalance between consumption and production capacity. Any budget deficit this would bring about on paper would be largely offset by the revenue from increased business activity. And any budget deficit remaining could not cause inflationary pricing unless demand should outstrip our capacity, a remote contingency we could correct later if necessary. Some increase in Federal debt at this time is not so serious when it is realized that at the close of 1946 it amounted to 123 percent of our annual gross national product. At the close of 1956 it amounted to only 67 percent.

III. THE POSSIBILITY OF FURTHER ADVERSE TRENDS

No one has a crystal ball that works. Let's consider the possibility that we may not continue to have major sectors of the economy turning upward as others turn down. It is conceivable that during a period such as the present, when housing, automobiles, appliances, textiles, and agriculture are slowed down, other major sectors may react also. For example, it is an undeniable fact that the billions of added consumer purchasing power that resulted from augmented consumer credit during recent years would be lost if such debt merely stopped expanding. This consumer purchasing would be curtailed still more drastically if people paid off old debts faster than they incurred new ones.

Likewise, further curtailment of inventories, with the resultant loss of production, can certainly take place from the current economic level. Furthermore, there is no law that says capital investment will continue at its present rate, a rate that has already created productive capacity in most manufacturing industries beyond our present ability to buy.

Even our spending on national security, considered by some as the most stable prop of our economy, may diminish if our international policies bring constructive results.

These are not predictions. They are possibilities, and it is these possibilities that pose our gravest problems, that deserve our most serious study. In such a study we must recognize what effects a turndown would have on the budget for the fiscal year ending in 1958. The Bureau of the Budget has based its guess on a continued increase in income and profits, an increase that would net about $3 billion of additional taxes. Hence a leveling off, a plateau, would reduce anticipated revenues by $3 billion. Even a minor drop would mean a real budget deficit unless spending were curtailed. Obviously a bigger drop in business would mean a bigger deficit.

IV. COMPENSATORY SPENDING AND STANDBY TAX REDUCTIONS

We should be prepared for the deficit mentioned above, and be willing to increase it temporarily by spending and by tax reductions, to increase consumer purchasing power, to provide employment, and to promote economic stabilization. Otherwise the decline could snowball, leaving us with a much more serious problem.

The spending should be in stages as needed. We should have a series of projects planned and ready, some of which would utilize money and labor effectively at once; others that require more time could be brought along later as the need arose.

The tax reductions again should be for the low income individuals and small corporations. It is these that have the fewest savings, hence they are the ones that will first put tax reductions to use as either increased purchases of consumer goods or increased capital investment as needed. Because action may be needed on short notice, I recommend that carefully defined standby power for such tax reductions be delegated to the President by this Congress.

With advance planning and with a willingness to use our fiscal and budgetary tools as outlined above, the Federal Government can help on the many new schools that are so badly needed, we can build roads and other public works, we can devote more to medical research and to public health, we can give more aid to housing and to the redevelopment of our urban areas. We can help small business and the consumer. We can help make up the many other deficits in our economy, all of which in turn will aid in providing jobs, purchasing power, and economic progress.

(Mr. Pennybacker subsequently submitted the following:)

ADDITIONAL STATEMENT OF MILES PENNYBACKER FOR THE RECORD OF THE HEARING ON JUNE 7 OF SUBCOMMITTEE ON FISCAL POLICY

The opinion has been expressed at this hearing by our friend Dr. Robey of the National Association of Manufacturers that a generalized statement as to the recessionary trend in small business compared to big business cannot be supported by accurate statistics. I submit the following statistics for the record, with the request that this data be checked, corrected if necessary, and brought up to date by the staff of the joint committee:

PROFITS AFTER TAXES IN MANUFACTURING CORPORATIONS

TABLE 1.—*Income after taxes*

[In millions]

Assets	1947	1948	1949	1950	1951	1952	1953	1954	1955
$250,000 to $1,000,000	$692	$587	$332	$574	$618	$479	$446	$395	$532
Over $100,000,000	3,779	5,611	5,077	6,697	6,282	6,136	6,883	7,448	9,873

TABLE 2.—*Income*

[In cents per dollar of sales]

Assets	1947	1948	1949	1950	1951	1952	1953	1954	1955
$250,000 to $1,000,000	5.1	4.4	2.9	4.4	2.5	2.1	2.0	1.9	2.3
Over $100,000,000	7.2	8.6	7.6	8.6	6.6	5.9	5.7	6.5	7.4

Representative MILLS. Thank you, Mr. Pennybacker.

The next witness is Mr. George J. Burger of the National Federation of Independent Businesses, Inc.

Mr. Burger, we are pleased to have you with us and you are recognized.

STATEMENT OF GEORGE J. BURGER, VICE PRESIDENT, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. BURGER. Mr. Chairman, I want to take the time to add the final vote of confidence in your splendid action as chairman of the committee and also state as the ranking majority member of the Committee on Ways and Means for sympathetic hearings on the problems of small business on tax relief the many times I have appeared before your committee.

At the same time I want to pay tribute to Senator O'Mahoney for his consistent action on antitrust action.

Representative MILLS. Thank you.

Senator O'MAHONEY. Thank you.

Mr. BURGER. I am George J. Burger, vice president, National Federation of Independent Business, 740 Washington Building, Washington, D. C. Our head office is located at Burlingame, Calif. with division offices in Chicago, Cincinnati, and New York City, and the legislative office here in Washington, D. C.

We are the largest organization of independent business and professional people in the country from the standpoint of directly supporting individual members. There are about 100,000 voting members on our rolls. The number is growing daily. We are unique because our members themselves determine our position on every issue by their direct vote through mandate ballots. It is safe to say we have our fingers on their pulse.

I have talked with our members, read about their needs and problems in their letters, checked closely on their thinking through the result of their thousands of votes—they have many problems, but underlying all is the single basic problem of trying to make the current individual sales income dollar do the job of a future two, which they must do if they hope to survive the inflation that is threatening greater devastation to our country than 1 billion hurricanes of the type that recently scourged the Midwest.

Our members have asked tax reductions. Current rates, perhaps the highest in our Nation's history, are grinding them down. The Senate and House Small Business Committees have told you this. The executive branch knows it, judging by recommendations by the President's Special Cabinet Committee on Small Business and by studies of the Small Business Administration. Both of your parties recognized it in their platform programs last summer.

Some may say "Well, the dollar is devalued all across the board * * * for small business as well as for big corporations, labor, farmers and Government. All are receiving more dollars of less value." But this isn't so. Competition has reduced the number of dollars today flowing into independents. They are not riding the wave—they are not staying even.

And no one can see anything but further inflation ahead. A bad situation could easily become worse.

A leading financial daily newspaper a few days ago reported a consensus of opinion among 70 economists, bankers, industrialists and Government people that the biggest worry facing our country is inflation.

Reports by Bureau of Labor Statistics do not ease these fears. They show a 0.3 of 1 percent increase during April in the cost of living. This brings the index to a new record high for the eighth straight month.

What is behind this? Well, a leading national columnist wrote in her May 14 column:

Spiral in Steel—Again.—The price of steel will be raised sharply in July. It will be the 11th annual price increase in steel since World War II and it could be the biggest for the entire period. The price rise will be felt at once throughout the Nation. It will add millions to the Federal budget because the Defense Department is a large buyer of steel. It will help push the cost of living higher in many open and hidden ways.

Dr. Frank Kidner, economics professor at University of California, said recently:

It seems to me that behavior of prices and wage rates will continue, substantially on the upward drift.

A leading financial daily reported:

Rubber workers pick Goodyear as the target for wage-boost drive.

It discloses that union and management have agreed to no public disclosure of union demands and company proposals, no progress reports, until either a settlement is reached or negotiations break off. The prisoners in the cock—consumers and independent business—aren't allowed even to hear their trial.

What is behind this inflation that is driving up Government costs? For one thing, the wage and price policies of unions and large management, by which both are digging their own graves, and digging graves for the rest of us.

Mr. Chairman, this leads me to a situation which I believe it is a responsibility of your committee to solve.

Some sense of order and the general public good must be brought into the field of union and management wage and price policies. We are not antilabor nor anti-big-business, and we are not interested in promoting Government controls. We should prefer the needed corrections in outlook to come about by labor and management themselves. But I do personally believe that if this does not come about this way, then some superior authority must be brought to bear, and my contention as to the problem of inflation today is substantiated by a statement of former President Truman, who said:

> Some appeal has been made to leaders of key industries voluntarily to curb a growing appetite for higher profits. So far the response has been feeble and discouraging. If industry continues to be unresponsive, it may well be in for some Government pressure to do what it ought to have the good sense to do voluntarily. I know that labor leaders are giving serious thought to their role in this situation.

My contention is further substantiated by the statement of Senator Capehart on the floor of the Senate under date of May 27, 1957, where he said:

> It is general inflation which is breaking our back and will continue to break our back. My best judgment is that we in Congress ought to be paying some attention to the question of general inflation.

Housing Chief Albert M. Cole has also recognized the serious danger prevalent in the trend today when he stated under date of May 27, 1957:

> If present trends should get out of hand and lead us to runaway inflation, we may be living in tents because we won't be able to afford houses.

During the steel strike last summer I was privileged to confer with Dr. Arthur Burns, then economic adviser to the President and Chairman of the Special Cabinet Committee on Small Business. I told him that in my opinion the public interest was at stake and that in view of the situation existing I thought the administration should act by investigating the matter impartially and (1) if it found the demands of labor just, tell the companies to "Pay the advance," but (2) if it found profits wouldn't justify the increase, then tell the unions "No soap."

The doctor asked if I thought the administration should take such a position. I said I wasn't concerned who was in the White House—Mr. Eisenhower, Mr. Truman, Mr. Roosevelt, or someone else—but that somewhere along the line someone had to do something, or someday all of us will end up in the poorhouse.

For this reason I think your committee should give serious thought to the possibility of setting up a Federal Board of Arbitrators available to consider the equities involved, including the public welfare, when labor and management reach an impasse. In case of matters reaching the strike state this Board could be empowered to investigate and bind both parties to its decision for or against the price-wage increases. In other cases it could be empowered to investigate all the facts and announce them clearly to the public, spelling out the anticipated effects in the clearest possible language.

This would not be any violation of the antitrust laws, nor would it be the creation of another Government agency, nor would there be any standing committees. But such action would be instituted by law if and when the actions of major industries operating in the interstate commerce at both the management and labor level again show evidence of fueling the fires of inflation.

I submit we are in a financial crisis. It has nothing to do with partisan politics, being something that has been building for the past quarter of a century. But if we don't meet it flatly now, we are evading our responsibility not only to ourselves but to generations to come.

Finally, Mr. Chairman, I am neither an economist nor a lawyer. But I have spent better than half a century close to the grassroots in small business, and I have a fair knowledge of the operation of some of our bigger industries. I think I am in a position to know the score.

And it is my hope and trust, for the future good of our Nation, that my remarks will be considered, and that they will help your committee make constructive recommendations. I do think that if such action is taken by your committee that Government would find it possible to grant the badly needed tax relief to independent business. If we accompany this by a definite program for vigorous antitrust enforcement to clear the path to freer, fairer opportunities for all, then I do believe we will be well on our way to genuinely healthy economy.

On behalf of our members, I want to thank you for the privilege of appearing before your committee today. It has been a pleasure to be here, just as it was a pleasure to be before the committee when it was chairmaned by the late and great Senator Robert Taft in 1947.

Thank you, Mr. Chairman.

Representative MILLS. Thank you, Mr. Burger.

We appreciate all of you gentlemen taking time off from your busy lives to be with us and to make the contribution you have to our thinking with respect to the problems before the subcommittee.

Senator O'Mahoney, do you desire to interrogate the panel?

Senator O'MAHONEY. I have been tremendously interested in the statements which have been made here. There seems to be such a great variety of comment among those who have testified that if we could stimulate a little close-fire of discussion now among all of you, I think it would be most helpful to our understanding of the problem.

Beginning with Mr. Wilde of the Committee for Economic Development, I am prompted to ask him if spending by the Federal Government is any more undesirable from the point of view of stabilization of the economy than spending by individual people, by cities, towns, counties, and States.

I would judge from what was said here by all concerned that there is a general agreement that demand from every source of consuming power has increased, except that there are soft spots in the economy. I think it must be agreed by everybody concerned that the farmer and the small-business corporation and the small-business firm, the small-business individual, are suffering in an economy in which the Government has stimulated the profits of large business.

I would like to have your comments particularly, Mr. Wilde, upon, let us say, the rapid tax amortization which facts before the Senate clearly show has been utilized for purposes far beyond actual defense.

Mr. WILDE. Senator, I shall answer your last question first.

Senator O'MAHONEY. Take them as I gave them to you.

Mr. WILDE. First, I think that total governmental expenditures are never quite as desirable as the expenditures of the individual. I think there tends to be an inherent waste in governmental expenditure which the best of administrations, whether it is Democratic or Republican, cannot overcome, and that is particularly true when it occurs at the national level instead of the local level.

In the small towns that I have lived in in New England, governmental expenditures are pretty well considered and are made with due respect to the taxpayers' dollar, but when money is spent impersonally in Washington for the benefit of New England or some other place there isn't the same weighing of the merits and the same conservatism, so I say that governmental expenditures are not as desirable on an overall basis as private expenditures, whether they are made by a consumer or by a plant that is expanding itself.

However, I think that is too simple an answer. You have to get down to cases and there are certain things where governmental expenditure is very useful.

Senator O'MAHONEY. Isn't it a fact that there is a great demand in the country for services that only Government can render?

Mr. WILDE. Yes, there is a tremendous demand and I think part of it must be met because it represents things that only Government can do. But there are many other expenditures which we ought to be pretty reluctant to embrace, at least when we are trying to do two things at once. We are trying to build an adequate national defense and help the world against a very vicious form of society. We have to give that priority and this runs into a great deal of money. At the same time we are anxious to improve our material standard of living within the country. We can't do those things right overnight, capable as we are, so I say we have to sharply distinguish between those things that Government must do because only it can do them and those things that had better be deferred.

I personally think, for example, that we haven't the current capacity to do all these things and finance a large Federal school program. I don't think it should be done by the Federal Government. I think that should be done locally. That is personal philosophy.

Senator O'MAHONEY. There is a fact that hasn't been mentioned here at all and which I think I ought to throw on the table for your consideration.

If you were to examine the budget in brief as published by the Bureau of the Budget from the Executive Office of the President you would find that the major national security expenditures about for $43 billion-plus of the $71.8 billion, and that the next highest expenditure is $7.4 billion for interest upon the national debt.

This annual expenditure of carrying the debt is $2.4 billion greater than the entire appropriation recommended in the President's budget for agriculture, which is about $5 billion. Veterans benefits and payments also account for $5 billion. Then the expenditure goes rapidly down. The expenditure in the President's budget for the development of national resources in the United States is only $15 billion, and the strange fact is, not generally taken notice of, that the general activities of Government, including legislative and judicial purposes, the cost of all of the courts in the country, the cost of Congress and everything it does, the management of personnel through the Civil Service Commission and otherwise, FBI activities, and so forth, all amount to scarcely more than $600 million.

On a chart which sets forth the total of Government expenditures, these expenditures for what once used to be the normal activities of

Government, the making of the laws, the enforcing of the laws, would scarcely make a pinpoint on the diagram.

Mr. WILDE. Senator, I would like to comment on that interest charge, because of course it is very often mentioned in connection with any financial business such as insurance, which of course is one of my principal activities. That increased interest charge represents a scarcity of real capital in this country. The scarcity arises out of our moving forward, building new plant, whether it is private or governmental, and using of capital to increase our productive capacity. Most of it has been used constructively. That market price for money has risen because it has grown scarce. We had a subnormal investment in plant in this country for 20 years or more. We had some certain plant increases due to war, but when we got through the depression and got through the first war and ran into the Korean war, the total plant capacity in this country was inadequate for the demands of the people. They wanted more things, whether it was automobiles, or washing machines, or houses. We all think that is a good thing because we want to improve our standard of living, but we were short of plants. I think probably today we may be not short of plant on an overall basis, but probably still are in certain categories.

I don't understand my friend's criticism of the past national policy in accelerating plant development. I think, if we hadn't done it, we would have been in very great trouble today. If we hadn't increased steel capacity 40 or 50 million tons, how could we possibly run our national defense and have automobiles and other things? I think this plant acceleration, in which I am not personally interested but just have been observing as an investor, has been one of the wise national policies. I don't say that we need it from here in. I don't know. We still might in some areas. The total plant capacity in this country has been brought up to a point where we can hope to have both defense and an increased standard of living if other factors were in balance, but we are a little short of skilled labor in many respects.

The labor market in respect to housing is exceptionally tight in many places and that leads inevitably to inflationary prices and inefficiencies. It is just human nature. I have just been through it because our company has been building a building. We have been delayed at least 6 months. They couldn't get help. Part of that help shortage came because of governmental expenditures in new plant in the area and this experience is repeated in other places throughout the country.

You must remember that we don't deal in money in the country except as a means to do what we want to do. We deal in things and the major problem we face is to produce things at stable prices. Price relationships have been distorted. I don't know enough about the theory of administered prices, but it has always been my observation that if there is enough capacity somebody will break the price and you will get a more favorable price. So I am not afraid of building too much plant, because that will be to the consumer's advantage. But there are millions in this country who are tending to be priced out of the market. To that extent I would agree with the theory of considering the consumer.

Senator O'MAHONEY. I assume that a life-insurance company is primarily concerned with the welfare of the individual.

Mr. WILDE. We hope we are.

Senator O'MAHONEY. That is right. The suggestions for curtailment of Federal Government spending seem to be directed toward those expenditures which were once called the expenditures of the welfare state. Do you think it would be advantageous to the life, the longevity, of individual policyholders to cut down on these welfare expenditures?

Mr. WILDE. Senator, I am certainly not in that camp. I didn't know our business was. I shouldn't talk about everybody in the insurance business. I don't represent them here. I am just an individual in that business. My personal philosophy, and it has particular relevance to my business, is to be just terrified of inflation. I think it is unfair and endangers the country's prospects for success. Look at the countries that were great, like France. They were ruined by inflation.

My objections to Government expenditures are more in the areas in which I think they have been a failure. Look at agriculture. We have been in that business for 90 years, since the company was started. I know a little bit about it from painful experience. It is a very difficult business, and I have a great deal of sympathy with the individual farmer. But the fact is that under both Democratic and Republican administrations, with capable men in the Congress and in the Agriculture Department struggling with this problem for more than 20 years, the present policy is a failure from a practical standpoint. The farmers are not served well and the citizens generally are not served well.

That type of thing is something we have to keep struggling with and get a good answer for.

Senator O'MAHONEY. I agree with you. Do you think there is any possibility of finding the answer and realizing the fact that agriculture is primarily still an activity of individuals, while industry is primarily an activity of organized groups through the corporate form, and that the larger corporations are managed by employees and not by the owners?

We have in effect in the great corporations collectivist economic states because the stockholders own only an infinitesimal fraction of the overall assets. It is boasted by managers of big corporations that individual ownership for individual persons amounts to less than 2 percent of the total, for example, so that the bulk of the stockholders exercise no managerial power except when they sign a proxy, whereas in the agricultural industry it is the individual farmer and his wife and his children who go out on the land and try to raise the crops.

Mr. WILDE. Do you mean, Senator, that because of this proxy management the economic results differ? I couldn't quite follow you on it.

Senator O'MAHONEY. What I am trying to say is this, or to propound this question: Don't you think it is significant that the individual now who operates on the farm or even in small business is in a very different category from the management of the great industrial corporations which turn out the commodities, which in the modern world we need and want, and that that is an adjustment which has not been made?

Mr. WILDE. Could it have been made? The big operation has many technical advantages over the small operation. It applies to small business and it applies to small farmers.

Senator O'MAHONEY. Take some of the facts that were developed by Mr. Goldfinger. Is there any question about the statistics that he gave? You have on page 6 of your paper a comparison of labor income with corporate income, and then below, the unbalanced cash flow. What views do the members of the panel have on this point of view?

Mr. Chairman, I am trying to get a debate going here somewhere.

Mr. GOLDFINGER. I would be prepared to expand upon that. I think that we got ourselves into a vicious circle in the past number of years, a vicious circle that reflects on this talk of general inflation, a situation that I would seriously question. In the first place, I see no evidence of general inflation now and I saw no evidence of general inflationary demand in 1956. We did have inflationary demand pressures in selected parts of the economy. There were high demand pressures for certain types of steel. There were high demand pressures for certain types of machinery and instruments, and for lendable funds, all related to the very high level and sharply rising level of plant and equipment investment. I think that we had an abnormal growth of plant and equipment investment in the past couple of years that was not only bad in terms of an unbalanced relationship to personal consumption, but also in that it created abnormal pressures within the economy. The Government attempted to respond by applying a tight money policy which raised interest rates generally, and which, by the way, hardly had any influence on the business-investment policies of the big corporations that were largely responsible for the sharp rise in business investment last year. I think we got ourselves in a kind of circle here where we have had this abnormal rise in business investment, largely based on the activities of big corporations. Then the Government moves in and tightens up the money supply and I would take issue with Mr. Wilde that the interest rate is simply the market price of money. I believe that the Government has a very important influence on what happens in the money markets as a result of the heavy weight of the Government debt upon those markets.

Senator O'MAHONEY. Of course Abraham Lincoln fought the Civil War with greenbacks and we are trying to fight the cold war by increasing the rate on the Government borrowings and tightening the rate on borrowings of all individuals and all businesses.

Mr. GOLDFINGER. Yes; and I think that this overall tight-money policy has affected large sectors of the American population and most economic sectors, hardly affecting, however, the one sector that was largely responsible for the inflationary demand pressures, through the large increase in business investment last year, based on these outlays of big corporations.

Senator O'MAHONEY. Mr. Chairman, pardon me for interrupting you. Our time for asking questions is limited. I wanted to see if I could get something specific in the way of an agreement among all assembled here. The spokesman for agriculture on the whole agree that there should be a farm program. There are some divergencies between the Farm Bureau and the Farmers Union, for example, and the Grange, but these three organizations all agree, do they not, that the farm population is not in a prosperous state?

Mr. BATTLES. That is for sure.

Mr. HAMILTON. They certainly are not as prosperous as they were a few years ago.

Mr. BAKER. They are in a depression, as you so well stated a moment ago, Senator.

Senator O'MAHONEY. That is my judgment now.

Mr. Pennybacker tells us in a very, very succinct statement, may I say, Mr. Pennybacker, and very clear:

> Small businesses, and small manufacturers in particular, are now in a period of recession.

Does the National Association of Manufacturers agree with that?

Mr. ROBEY. Senator, I don't think we will. It depends upon the particular part of the economy that you look at. There are some very prosperous small businesses. There are some big companies that are not doing so well either, so I don't think you could make a generalized statement of that kind and support it by an accurate statement of statistics?

Senator O'MAHONEY. Don't you think that the growth of the integrated company, both vertical and horizontal, in our time has created a problem that did not exist 50 years ago?

Mr. ROBEY. I think that probably is true.

Senator O'MAHONEY. Have we adjusted ourselves? Have we in Congress and in the Federal Government taken the steps essential to adjust the life of the individual and the life of the small-business firm to this integrated corporate structure that we now have?

Mr. ROBEY. It is our opinion that we need some more action and we think that should be in the matter of taxes.

Senator O'MAHONEY. I notice that two of the commentators, beginning with Mr. Wilde and then Mr. Fackler, spoke of definite restraints of spending. That is positive. Then both of you talked of reform in taxes. It was rather indefinite and vague, and it wasn't clear what particular reforms were wanted.

Mr. ROBEY. I don't want to take too much time on this, but I believe about 85 percent of American business is unincorporated, so a change in the corporate tax rate will not help the majority of small business. It will have to come through a change in the individual income tax. We think that is where we ought to go to work. We also think something needs to be done on the corporate tax structure. The particular bill that has us impressed at the moment is that bill introduced by Congressman Sadlak a few weeks ago, which is a 5-year program which would reduce the income tax of everyone. The first bracket tax rate would be reduced from 20 percent to 15 percent. All the progressive rates would be reduced. The top rate would be reduced over a 5-year period from 91 to a total of 42, I believe. The bill also has another amazing provision, which is that in any year where it does not appear that you could have this tax reduction without its resulting in a deficit, the President has the authority to postpone the reduction for 1 year, only 1 year at a time, but this so-called 5-year program could take 9 years to be fully realized. We think work in that field is what is needed.

Senator O'MAHONEY. May I ask Mr. Fackler whether he agrees with Mr. Pennybacker and Mr. Burger that small business is in a period of distress?

Mr. FACKLER. I don't think that they are generally in a state of distress. Small business and individuals are facing problems, very important problems, arising, in part, out of the inflationary conditions, rising costs, and the present tax structure. In an article appended to my statement I point out some of these things; I think, for small business the main problems can be traced back to the personal rate structure. I agree with Dr. Robey that a change in the corporate income tax isn't going to help small business and individuals very much.

Senator O'MAHONEY. Is not going to help them?

Mr. FACKLER. Is not going to help them. A change in the personal surtax rates would be far more important for the independent business and small business. I think that something needs to be done here first because very little revenue gained from the surtaxes, and yet they curb economic expansion of both present and prospective small-business men. The Government takes a good share of the gains and doesn't share in the losses.

Senator O'MAHONEY. Thank you, gentlemen; and thank you Mr. Chairman. The chairman, I know, has a quorum call on the House floor, so he wants to get in a few questions. I hope I have not blocked you.

Representative MILLS. Not at all, Senator, and I apologize to the members of the panel for being delayed this morning on other business. I had to appear before a committee of the House. Now I find we have a quorum call in the House and I must leave in a few minutes, but I did want to pose some rather general questions to the panel.

In the hearings thus far and during this week, we have been looking for answers to basic questions upon which sound fiscal policy should be based in the hope that we might be able to guide the thinking here in the Congress and the thinking throughout the country with respect to the ingredients of sound fiscal policy. We have attempted to get a clear picture of the economic outlook to determine whether economic conditions call for some easing of fiscal or monetary restraints in the interest of economic stability and growth.

We have tried to determine whether the effects of the actions so far taken or now under consideration with respect to reductions in the appropriations for fiscal 1958 will reduce actual Federal spending in 1958 and whether these effects materially change the economic outlook and the need for fiscal or monetary action as compensatory action.

Then on the basis of these first two questions, we have sought advice on the timing of changes in fiscal and monetary policies and, fourth, we have sought advice on the kind of tax changes which would be desirable should some such action appear to be called for, necessary, or justifiable. Most of you have covered in your prepared statements your own views with respect to these separate points, but I wonder if we could get from the panel some specific yes or no to some of these points that we are seeking.

Do economic conditions today, in the opinion of the panel, in and of themselves call for easing of fiscal and monetary restraint?

Mr. Wilde?

Mr. WILDE. I would say unequivocally no.

Mr. FACKLER. Certainly not, as far as monetary restraint is concerned.

Mr. ROBEY. No.

Mr. GOLDFINGER. I would say the current economic situation definitely calls for the easing of the whole monetary policy and for some easing up on these rising interest rates which are affecting small business, farmers, consumers, and other sections of the population.

Mr. BATTLES. Mr. Chairman, I don't know how quickly we can ease up on these rising interest rates and one thing and another.

I noticed here in the curve, however, the price curve is beginning in June to straighten out pretty well after a year of rise, so no doubt somewhere along the line this thing could begin to be eased up some.

Representative MILLS. That isn't the Consumer Price Index you are looking at?

Mr. BATTLES. Wholesale prices.

Mr. HAMILTON. It is very difficult to say just what the timing of these things should be, but at the moment I would see no reason for easing up.

Representative MILLS. Mr. Baker.

Mr. BAKER. Mr. Chairman, it seems to me that we need to make adequate appropriations for great priority needs for public investment, such as have been mentioned here, resource development, housing, health, schools, national defense, and international economic cooperation, and with those expenditures or added expenditures and additional economies where vital, the times do not seem proper to me now or in the foreseeable months ahead for a general tax cut, but the tax system or the whole revenue structure ought to be rebalanced, realined, loopholes closed, and personal exemption raised.

Mr. PENNYBACKER. I will limit my remarks at the moment to the specific question regarding monetary policy.

Representative MILLS. And fiscal.

Mr. PENNYBACKER. Thank you, sir. With regard to interest rates it seems to me quite obvious that corporations that are making hundreds of millions of dollars, only about half of which is paid out to stockholders, are not greatly influenced in their decisions with regard to interest rates, and that the increased prices of steel and other basic commodities have not been reduced as a result of higher interest rates. On the other hand, small and medium businesses that do not have access to such large blocks of profits and do not have ready access to the securities markets are immediately and more directly affected by increases of interest rates. In other words these high interest rates are inequitable and put the pressure where it is not needed. They are putting pressure on the businesses that are definitely in recession. Later I hope to comment on Dr. Robey's statement that recession isn't general in small business. I think it is.

Therefore, I believe that the monetary policy should be adjusted to permit lower interest rates, as is entirely within the province of the Federal Reserve Board. My written statement covers my views on fiscal policy.

Representative MILLS. Thank you.

Mr. Burger.

Mr. BURGER. Mr. Chairman, I was asked that question in my appearance before both the House and Senate Small Business Committees within the past 6 weeks during their investigations on the operation of the Small Business Administration.

Just 2 weeks ago I was asked the same question by the full committee of the House Banking and Currency Committee when they were considering the Small Business Administration. We deal with about approximately 100,000 small-business establishments throughout the Nation. They are all members. They are not groups. They are all individual voting members.

I can truthfully answer the question and say that we had one complaint about high interest rates, one and only one, but there is one thing that we are primarily interested in: If we are going to protect small business, whether incorporated or unincorporated, there ought to be something done to permit them to build up necessary reserves to take care of them over slow periods, over slack periods, and if that isn't done they are going to face even a more serious situation with the increases.

Mr. ROBEY. May I extend my comments, because I think the secretary just noted that I said no, that the economic situation is not such as to warrant a change.

I do not think that the economic situation warrants a change in the monetary policy. I think it is time to start looking at taxes.

Representative MILLS. Let me understand just exactly if I may now. There is a lot of difference between tax revision wherein there is no loss in revenue and what we refer to as general tax reduction, which presumably contemplates a loss of revenue.

To go into the second part and have this before you as you consider the first in extending your statement, we have been told by those who have appeared before us, by the staff of the Joint Economic Committee, and by the staff of the Joint Committee on Internal Revenue Taxation that, in spite of the efforts that are being made by the Congress and will be made by the Congress to reduce Federal spending in fiscal year 1958, Federal spending, as a matter of fact, will likely exceed the President's estimates of Federal spending given to the Congress in January of this year.

It is called to our attention even today, as it has been by these other groups, that if gross national product does not rise at least 3 percent in the calendar year 1957 we will have $3 billion less revenue than we estimate with which to pay these expenses in fiscal 1958.

What I am getting at is this: Does sound fiscal policy require, under present economic conditions and in the light of these developments with respect to Federal spending, that we take action or that we not take action, the result of which is to further weaken the effect of fiscal policy as a restraint upon inflation?

Fiscal policy producing an unbalanced budget would work contrary to curbing inflation. If we have inflation as a result of our fiscal policy, then greater restraints must be provided through monetary policy, with the effect that farmers, small-business people, and consumers feel the squeeze even more than they feel it today, and perhaps even other businesses throughout the country would be adversely affected. Do we in the long run then serve economic growth and stability in the adoption of a fiscal policy which fails to restrain any threat that may exist in the field of inflation?

That is what is concerning me and, I am sure, concerning other members of this subcommittee.

It is a wonderful thing to be for all appropriations and to be for no taxes, but it just doesn't happen to be responsible fiscal policy.

We are trying to find out, therefore, what does constitute sound fiscal policy for the fiscal year 1958 and, therefore, what our recommendations to the Congress should be with respect to the establishment of fiscal policy, and I am sure that every one here will agree with the other panelists who have been before the committee that the economic situation itself does not justify an unbalanced budget at the moment, or for 1958, and that, in the course of whatever action we take with respect to fiscal policy for fiscal 1958, we should gear fiscal policy to avoid deficit financing.

Is that the feeling of all the members of the panel?

Mr. GOLDFINGER. I would take some slight exception to that, because I think that the main action required now is a tax reduction on the individual income tax by increasing exemptions from $600 to $700 as a first step. I would go along with you, sir, and say that it would be wise to recapture the loss in revenue by closing loopholes, but I nevertheless would say that, whether or not the loopholes are closed, it is extremely important to redress this balance between consumption and investment, as a first step, and to bring the tax structure into some greater degree of equity. As I say, I think it would be wiser fiscal policy to recapture the loss by closing the loopholes, but, nevertheless, the first step and the important step would be a reduction in the individual income tax.

Mr. WILDE. Could I make an observation on this matter of monetary policy? Many people, who perhaps know more about it than I do, think it is entirely in the hands of the Federal Reserve. I don't think it is that simple, because we use two types of money. We use savings money and true capital and we use this manmade, bank money. If you try to use too much of this temporary, manmade, bank money you are bound to get into trouble. I insist all the best studies show that capital is scarce and that this money rate reflects the scarcity through capital. I know our company has no money. We borrowed the other day.

Representative MILLS. Gentlemen, the time has come for me to leave. I am sure Senator O'Mahoney has other questions, and, Senator, I will leave you in the charge of these very outstanding gentlemen.

Senator O'MAHONEY. How long were you planning to hold these gentlemen here?

Representative MILLS. That will be entirely up to you. I have to get to the floor to answer this quorum call.

Thank you so much for coming here this morning.

Senator O'Mahoney will continue.

Senator O'MAHONEY. May I say I have no intention of interrogating the panel now. I think that what has been said by the chairman and what has been said by the members of the panel has demonstrated that there is a substantial divergence of views here as to what should be done, and I am perfectly willing to allow all of you to make additional statements for inclusion in the record without any further prompting from me.

Is that agreeable?

Do you feel moved to continue the comment?

Mr. ROBEY. I should like, Senator, to make one additional statement, if I may.

Senator O'MAHONEY. Very well.

Mr. ROBEY. It refers to what Mr. Goldfinger just said. I cannot agree with him that what we need is an increase in the personal exemptions. I think there are a lot of reasons for it.

Secondly, I don't think that you could make up the loss of revenue from increasing exemptions by $100 by closing loopholes. I don't think we have that many loopholes. We evade taxes in a lot of ways or avoid taxes, but the loopholes are not what they are supposed to be, so that I just want to register my disagreement with the idea that the proper thing that needs to be done is increase the personal exemptions.

Senator O'MAHONEY. Mr. Pennybacker, I think you were indicating a desire to comment.

Mr. PENNYBACKER. Yes, sir; I wanted to register a dissent from the statement of the chairman before he left, from which Mr. Goldfinger registered his dissent, with regard to the question of whether or not our budgetary policy at this stage would result in inflation if there were a deficit. I think that this is an inflationary situation that is quite different from that which we have experienced in times past when there was a real shortage of production and what amounted, in those cases, to an excess of purchasing power temporarily.

The situation now is quite different. The price increases have been in limited areas of the economy and not general. In fact, many prices are tending downward at the present time. Government spending does not necessarily take place in those areas where prices are rising, and a lack of Government spending would not in itself bring about a reduction in those areas, because those administered prices on steel and on other commodities are going to be as high as the traffic will bear. They are not subject to the free and open market that the economists refer to. Consequently, I am not afraid of a small Government deficit at this stage. I don't think it would result in any added inflationary forces of consequence.

Senator O'MAHONEY. Mr. Hamilton.

Mr. HAMILTON. I wish, Senator, to make just a small supplemental comment on this question of the condition of agriculture. As I am sure you are aware, the Farm Bureau is convinced that the reduction in farm income is, to a considerable degree, a result of the accumulation of surpluses, which has depressed prices of some farm commodities, caused a resort to marketing quotas, reducing the production of some commodities, and diverted acres over into production of feed grains and livestock, and we feel further that the surpluses are to a considerable extent, a result of price supports that have been too high in the past. I just wanted to make that supplemental comment on the condition of agriculture.

Senator O'MAHONEY. That reminds me that, as you were reading your paper here, I made a mental note of your sentence beginning at the bottom of page 1, "Our worst depressions have followed periods of inflation, and there is no question but what effective action to prevent inflation would go a long way toward preventing serious depressions."

What effective action, precisely, does the Farm Bureau propose?

Mr. HAMILTON. Well, we propose the use of monetary and fiscal policy to create stable conditions if possible. I mentioned the question of using Federal Reserve policies effectively.

Senator O'MAHONEY. Effectively doesn't say how.

Mr. HAMILTON. Using Federal Reserve policies to regulate the flow of money and credit into the economy.

In other words, I agree that monetary restraint is a good weapon to use against inflation, and that budget policy certainly needs to be used.

Monetary policy and budget policy can be used to a degree to offset each other. If there is a time when you have to have a deficit or Government spending has to be high, then you have to put more emphasis on monetary policy. We would say that at the present time the budget should be balanced and some payments made on the national debt, for example. If you were to achieve that objective it would be possible to ease the monetary restraint.

Senator O'MAHONEY. Did you agree with the statement made by Mr. Robey, which also begins at the bottom of the first page of his statement:

> Hopes for tax rate moderation still ran high when, in the budget message for fiscal year 1956, released in January 1955, the President stated:
>
> "However, further tax reduction remains a firm goal of the administration, and our policy is directed to achieving both the savings in expenditures and the economic growth that will make such reductions possible."

Dr. Robey proceeds:

> Next year, however, in his budget message for fiscal year 1957, tax reduction was subordinated to a new doctrine, when the President stated:
>
> "Budget revenues now permit us to undertake some new and expanded programs. * * * This budget reflects that purpose."

The question that was running through my mind at that time was, does this not indicate the basic trouble with the whole fiscal policy, that we are trying to have our cake and eat it, too.

We are engaged in a terrifically burdensome national defense program which nobdy proposes abandoning. It is calling for a constantly larger and more continuous contribution from the earnings of everybody in the country and all the organizations in the country. Yet at the same time the demand rises for Government aids and assistance and contributions, health, education, welfare, natural resources, and so forth, without which the economy could not actually run, and nobody here has as yet solved this problem. Do you have any comment?

Mr. BURGER. May I interrupt just a moment?

Senator O'MAHONEY. Yes.

Mr. BURGER. I would like to ask those representatives from the farm industry, do you believe it is a healthy state of affairs that the Government has tied up in commodities about eight to nine billions of dollars? Do you think that that program should continue?

I am asking the farmers' representatives.

Mr. HAMILTON. I would like to comment on that. The answer to Mr. Burger's question is that I don't think it is a healthful state of affairs. The policies that have led to this have been a bone of contention for a number of years and the Farm Bureau as an organization certainly doesn't feel any responsibility for this accumulation of surplus farm products, because we have opposed the price support policies which we feel have been responsible for the accumulation.

As Senator O'Mahoney correctly said, we all agree, that is, among the farm organizations, that some price support program is necessary, but in general we in the Farm Bureau would be for a lower level of price supports and for emphasizing the development of market demand. I couldn't go along with all that Mr. Battles said about abundance. Certainly no one wants to short the consumer, but we can have plenty for the consumer without having these great surpluses that depress prices and lower farm income.

Senator O'MAHONEY. Did not the Farm Bureau favor the program that was written into law a few sessions ago by which surplus products were to be sold abroad for currencies of foreign nations to be expended abroad?

Mr. HAMILTON. We feel that we were one of the original sponsors of that legislation.

Senator O'MAHONEY. That is what I thought.

Mr. HAMILTON. But we have never regarded it as a satisfactory idea for a permanent program. Regardless of how we accumulated the surpluses, the fact is that we have them and that they are burdensome to the Government and to the market. We proposed Public Law 480 as a device for turning these surpluses into something constructive. It was our hope that the Public Law 480 program could be used to get surpluses down to a manageable level and then liquidated.

Senator O'MAHONEY. This committee I understand, will have a special session devoted to agriculture so I am not going to pursue the matter with you except to ask you if the three organizations do not agree that the farm problem has not been settled.

Mr. BATTLES. I think that is exactly right, and I think you hit the nail right on the head when you said we need a new approach and I think it is up to all of us to work on this approach. No one is satisfied with $8 billion worth of farm products in the Federal bin anywhere, and yet to say this program has been completely unsuccessful, I don't think is fully accurate either.

Senator O'MAHONEY. I can't refrain from saying for the record that while the farm subsidy like any other subsidy is one which should be avoided and we ought to unite our energies to eliminate the necessity for this, nevertheless, I think an examination of Government policy will show that the farm subsidy has not been as expensive to the United States Treasury as the various other subsidies that we pay and which industry makes no objection about. The maritime subsidy, is an example. The rapid amortization subsidy is another example, and so forth.

Mr. BATTLES. And these subsidies are often for a purpose. In other words, in agriculture we don't complain about some of these things that have happened to other segments of the economy. We think that perhaps they have served a real useful purpose and what we need to do is continually be in a position to appraise their continued usefulness.

Senator O'MAHONEY. Doesn't it all boil down to this: that we have been going from year to year with stopgap remedies for the whole fiscal policy instead of coming to grips with the basic thing, which is, as I see it, that for almost 50 years now this country has been engaged in war, either actual shooting war or economic war, trying to prevent Soviet dictatorship from taking over, and that demand upon our resources is so great that the demand which is also made by all groups in our population for normal civilian operation as though we were at peace creates the impact.

Mr. BATTLES. Overshadows the whole thing.

Mr. BAKER. Mr. Chairman, let me say one thing about these commodities that happened to be owned by the Government.

As I pointed out, the farm policies in the last 4 years have been very seriously maladministered in our opinion. Somewhere close to 5 to 6 billion have been wasted. With farm income dropping every year, as Mr. Battles pointed out.

At the same time I don't know how many dollars worth of commodities it is, but in a world where we feel called upon to spend upward of $60 billion a year for national security, there is some point to owning some wheat and some cotton, and some other storable goods, and probably even some storable processed products of perishable commodities as part of a general national safety strategic reserve, so that not the entire amount, I think, Mr. Burger, of what Commodity Credit Corporation may happen to own can be sneered at and laughed away saying, "We don't need these things." I think we would be very seriously concerned at this table here today if there were no carryovers of any form of commodities on hand.

Mr. BURGER. Had this country ever existed before without carryovers in agriculture?

Mr. BAKER. Not that I know of. I think that representatives of other nations at international meetings that I have attended, where their supply of these commodities start getting less than 2 or 3 months' supply start getting worried, particularly when nobody knows whether there will be a rupture of peace or a huge flood or a large drought.

Mr. BURGER. Aren't these foreign nations today in the agriculture field producing now what they weren't producing?

Isn't the indication in many of those countries that they don't want this excess stuff over there? Isn't Canada raising Cain about that situation now?

Mr. BAKER. No, sir; Canada is not raising Cain, as I understand it, about Public Law 480. Canada very bitterly objects to the way the administration is carrying out the wheat export subsidy program and that stems almost entirely, Senator, back to 5 years ago now, 4, better than 4, to the clumsy manner in which our representatives handled the negotiations for the extension of the International Wheat Agreement.

Senator O'MAHONEY. I don't want to foreclose the chairman and the members of the committee who will sit here when the agriculture problem is the center of discussion. I will close this now by creating the opportunity for the United States Chamber of Commerce and the National Association of Manufacturers to make a comment as to whether or not in the belief of their respective organizations it isn't essential to prevent small business from further decline?

Mr. BAKER. Mr. Chairman, could I introduce the statement with something that I think may stimulate their expression?

Senator O'MAHONEY. Anything to stimulate it. Yes, indeed.

Mr. BAKER. In watching the development since election night in 1956, when in effect President Eisenhower announced this policy that was objected to here at the table this morning, the campaign that has been waged by these representatives' organizations against the President of the United States and his economic and humanitarian policies has been so far fabulously successful, it occurs to me, and has completely blocked any rational consideration by the Congress up to this day of the meeting of such needs as schools, health, natural resources development, purely by what seems to me to be an almost completely fictitious budgetary scare.

Senator O'MAHONEY. That is a comment, not a question.

Mr. FACKLER. Mr. Chairman, that is comment that I think we can best ignore. The purpose of the discussion here this morning is to talk about Government fiscal policies and you specifically mentioned the question of small business. The National Chamber of Commerce is just as interested in small business as any of the people sitting around this table. After all, we have a great many members who are small-business men and are contributors to the national chamber. We represent small business as well as big business.

As to this question of small business, they do face particular problems. I think one of them is the tax burden and another is the tight-money problem. But printing more money is not going to help small business. That is what easing of credit would do—print more money. We do need a study, such as that proposed in the Presidential recommendation for a commission to study financial institutions, and the whole monetary system.

We do need more study as to how our financial structure and financial institutions ration credit and capital, when there is a critical shortage of savings in a restrained, inflationary situation. Bank credit and long-term capital differ. There is some evidence that perhaps small businesses do not get a proper share in the capital rationing process. We don't know. There is an awful lot of vague talk and loose talk. We need a lot more study on how the market actually does ration capital and credit, what institutional reforms would make the market work better. This would be most helpful to small business. We urgently need personal income-tax relief, reduction of surtax rates, so that the reserves which were mentioned could be built up, and venture capital for growth and expansion of individual businesses be made more readily available.

Small business does face important problems and we recognize them. There is much that could be done to help and encourage small business, but merely printing money is certainly not going to help.

Senator O'MAHONEY. Do you recognize a fundamental difference between small business and big business in the small business is primarily owned and managed by the same individuals, whereas big business is on the other hand owned by a multitude of small stockholders and managed by employees?

Mr. FACKLER. Certainly there are some differences, but I don't know how important those are from the standpoint of economics or the present discussion of fiscal policy.

Senator O'MAHONEY. I wonder if you do regard them of any importance.

Mr. FACKLER. Of course I do. We have big business in this country, in part, because of technological innovation, the economies of scale and mass production and the need for large aggregates of capital. Our standard of life depends, in part, upon such advantages. We have had to take big organizations to perform the economic functions in particular lines of production, whereas small business operates best in a lot of other lines.

I don't think that there is any great difference, though, in the type of economic functions that they do perform. It is a matter of technology and organization.

Senator O'MAHONEY. Which should have priority in the consideration of Government in the action it takes, the people or the organizations which the people form?

Mr. FACKLER. People are just as dependent on corporations as they are on small individual businessmen. I think we ought to take the view of the consumer—after all, we are all individual consumers—and what is best for the growth and expansion of healthy economic life.

Senator O'MAHONEY. I agree with that point about the individual consumer.

Mr. FACKLER. Of course there are individual interests, but I think we make a mistake when we try to divide up people into groups and say "Your interest is this, your interest that, and your interest is something else," when actually the problems under discussion cut clear across the board and affect all of us.

Senator O'MAHONEY. The President's Council of Economic Advisers does precisely that thing in some of the statistics that it affords to us. These figures show, as I pointed out yesterday, a steady increase since 1951 in the amount of money distributed as dividends and in the amount of money collected as interest; a steady decrease in the profits and the income of the farmers; a steady decrease in that, year by year. And of course then in small business too the group where management and ownership are combined and where the spreading of the activities of integrated companies make it difficult for the so-called independents.

Mr. FACKLER. But let me point out that in taking these broad aggregates we lose sight of a lot of things. Total farm income has been going down but also the number of farmers has been going down. It is important to realize that just taking these aggregates over time don't make very much sense. I am not defending particular companies or profit positions or any particular industry, but if you take corporate profits over time, profits before taxes, as a percentage of gross private output (the output of the economy in the nongovernmental, private sector) they are lower, and have been lower, than in 1939, much lower than in 1929, and in only 1 year, 1950, have they been up proportionately in recent years.

How can you question profits of corporations as opposed to the interests of some other groups in the economy?

Senator O'MAHONEY. Who has a copy of the latest issue of the Economic Report?

This chart is of great importance I think in connection with what has just been stated. This chart appearing on page 8 on corporate profits shows that these corporate profits back in 1939 before taxes amounted to $6.4 billion. Then we skipped 9 years to 1948, because the page isn't big enough to detail the changes. I do know that the corporate profits began to increase after 1939 and 1939 was an increase over the conditions that existed during the depression.

Mr. FACKLER. At one time they were negative, sir.

Senator O'MAHONEY. It is right. In 1948 we had $32.8 billion, and on down to 1956 we have $43.7 billion. The chart also shows that dividend payments and undistributed profits throughout this period from 1948 to the present time have been substantially higher. Beginning in 1951 the total of dividend payments and undistributed profits amounted to more than $20 billion. And it would seem to be about $21 billion, and in 1956 the total amounted to about three or four billion dollars more.

Mr. FACKLER. Yes, sir. You are examining these figures by themselves, without relation to the value of total product produced in the private sector of the economy. If you take them as a percentage, they are no higher. In fact they have been declining. They were actually lower in 1956 than they were in 1955, and considerably lower than they were in 1950—on a much larger capital base, too, I might add.

Gross private product has increased. The price level has doubled since 1939. Compensation of employees has gone up just as rapidly, percentagewise more rapidly, than profits. You just can't look and say "Well, in 1939 they were $6.4 billion and now they are $43 billion before taxes."

Senator O'MAHONEY. You are aware of these studies of the Brookings Institute which show that the number of employees in the joint corporations has been steadily increasing and now constitutes a very very large percentage of the total number of persons employed.

Mr. FACKLER. Yes, sir. The number of self-employed has been going down over time, just the same as the number of farmers relatively has declined.

Senator O'MAHONEY. That is the basic difficulty we are confronted with.

Mr. FACKLER. The problem, you are saying, is one of economic growth. The farmers do have problems. All industries do, which must shift resources to other uses.

Senator O'MAHONEY. It is more than growth. It is economic change.

Mr. FACKLER. Structural change. But that is part of economic growth. Although these changes create farm problems, we still can produce much more food with a relatively smaller proportion of our people employed in agriculture. This is one of the advantages of a developed economy. In an underdeveloped economy most of the people are in agriculture just eking out a bare subsistence living. The structural changes and growth do create serious problems of resource shifts among sectors. But we should not let these problems obscure the basic issues which we are trying to solve here today.

Senator O'MAHONEY. That is right. I see Mr. Goldfinger would like to get in.

Mr. GOLDFINGER. There are some structural changes that are quite important and I would agree with Mr. Fackler on that, but I think we would disagree on what structural changes have been of great importance here. One change that some of the farm representatives noted before was varying degrees of competition or no competition in different sectors of the economy, and I think that if you could break down the aggregate profit figures into different industry groups you would find some very interesting factors. For example, we have been talking about price increases on and off during this morning and someone mentioned steel. All of us know from the newspapers that the assumption is that the steel industry is going to raise its prices again on or about July 1, presumably because of an increase in wages under the terms of the contract that the steel companies negotiated with the union last year.

United States Steel in 1939 earned in profits before taxes 13 cents for each hour worked by all employees. That is wage and salary employees, 13 cents an hour in profits before taxes in 1939. In the first quarter of 1957 United States Steel's profits at an annual rate—that is before taxes—were running at a rate of $1.80 for each hour worked by each employee.

In terms of a percentage increase, that is, profits per hour per employee per hour worked, that is a fantastic increase of over 1,200 percent.

Mr. BURGER. May I ask a question at that point? I will agree with you on those figures, but don't you think in fairness in the first instance that John Q. Public, if organized labor in the steel industry was aware of these profits and that the industry itself could absorb those those increased labor costs, their ultimatum could have been at that time, a year ago, as it would be now, that the steel industry as an industry can pay these increased wages without increasing the prices?

Mr. GOLDFINGER. Mr. Burger, the unions in key industries in the United States have pointed this thing out before. The United Steel Workers of America published detailed booklets on steel production, on steel profits, on steel wages, and all kinds of other financial and economic factors in the steel industry prior to the steel negotiations last year. Unfortunately much of this material does not get into the newspapers.

We, for example, the AFL–CIO, executive council last February asked Congress to hold an investigation and we meant an impartial investigation—let's put the books on the table and look into this whole wage-price-profit-investment relationship, especially in the key corporations in dominant industries because we believe if you look into this situation you would find examples of administered prices in key industries, of administered prices by huge corporations which dominate those industries, and industries in which wage increases can be absorbed without any difficulty at all.

For example, you mentioned in your remarks that there have been 11 price increases in steel since the end of the war.

Senator O'MAHONEY. I quoted.

Mr. GOLDFINGER. Yes. I would like to correct you.

There have been 21 rounds of steel price increases since the end of the war. You were relying upon the steel companies' announced price increases, but in addition to the announced steel price increases there are additional price increases. For example, in the middle of last year the steel companies raised the price of steel by an average of $8½ a ton. Thatwas announced in the press as one increase, but towards the end of last year and in the early part of this year, the steel companies have raised the price of steel by an additional average of about $4 per ton. Since the end of World War II we have had not only announced price increases by the steel industry, but we have had additional price increases.

Mr. BURGER. I want you to understand one thing. That I am not speaking anti one way or the other. I am talking for the overall good. I know as far as small business is concerned, and I am not a professional trade-association man, and that is that when price raises come along the line either in help or commodity in most instances in normal years they would absorb it themselves out of the gross profits.

Senator O'MAHONEY Gentleman, it is 5 minutes of 1 o'clock. I am sure you are all getting hungry. It has been a very interesting discussion, but in justice to the chairman I don't think I ought to prolong it now.

We are very grateful to you all, as the chairman said, for your kindness in coming down here and presenting these views. I am sure that if after the discussion here any of you feel like filing additional statements, the chairman would be very happy to receive them. I want to add the word promptly, file them promptly if you want them to be in the record.

The Chairman has handed me a letter which he received from Mr. John C. Williamson, director of the National Association of Real Estate Boards, who has prepared a statement which he would like to have inserted in the record. This will now be inserted in the record.

(The letter and statement referred to follow:)

NATIONAL ASSOCIATION OF REAL ESTATE BOARDS,
Washington, D. C., June 7, 1957.

Hon. WILBUR D. MILLS,
Chairman, Subcommittee on Fiscal Policy,
Joint Economic Committee,
House Office Building, Washington, D. C.

DEAR CONGRESSMAN MILLS: One of the questions suggested to witnesses before the Subcommittee on Fiscal Policy is: What types of tax changes would improve the competitive climate for new and small businesses, both corporate and noncorporate?

Residential construction, particularly rental housing, because of certain tax discriminations, is reaching low production levels while demand continues unabated and the rest of the economy surges forward. At the same time, the Congress, searching for a remedy, has approved in past years and is presently considering anew costly palliatives which have a pronounced effect on the Nation's fiscal policies.

I hope that you will take the time to read the enclosed statement which we respectfully submit for inclusion in the record of the current hearings of the Subcommittee on Fiscal Policy.

Very truly yours,

JOHN C. WILLIAMSON, *Director.*

STATEMENT BY JOHN C. WILLIAMSON, DIRECTOR, DIVISION OF GOVERNMENTAL AFFAIRS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, ON TAXATION OF REAL ESTATE INVESTMENTS

Mr. Chairman and members of the subcommittee, private real-estate investment, or the lack of it, particularly in the area of residential construction, has had a pronounced effect on the management and planning of our fiscal and monetary policies. Almost every year since the close of World War II, the Congress has enacted a major housing bill, and each has had as its underlying philosophy the neutralizing of the market's inhibition toward real-estate investment with Federal insurance of one form or another coupled with almost direct Treasury support.

Both the Senate and the House of Representatives recently approved housing bills which, following the custom of past years, are replete with provisions for cash grants, loans, and borrowing authority. This measure, upon enactment, will have a pronounced effect on the Nation's fiscal policies.

The rationale behind many of these Government proposals is to provide some counterbalance to existing tax policies which inhibit the investment of people's savings in income-producing property, particularly rental housing. Unfortunately, Congress now and in the past has sought to fill the need for this type of housing through costly schemes for public housing, direct lending at submarket interest rates, and triple Government guaranties of mortgages which almost make a mockery of the words "private enterprise," particularly when one appreciates that such schemes are designed to attract private investment. Probably the most controversial example of this is the title VIII military housing program whereby one Government department insures the mortgage, another agency guarantees the payments to the mortgage, and a third agency employs a public-debt transaction to purchase the mortgage. The multi-billion-dollar involvement in this program alone has a pronounced impact on current fiscal policy.

We believe that certain changes in the tax structure, directed at provisions which are of a discriminating nature, would go far to reduce the Federal involvement in these programs and their impact on fiscal policy.

First, and probably the most important, is the present system of taxing real estate investment trusts as corporations, thereby making impractical the pooling of savings of small investors.

On November 22, 1955, James C. Downs, nationally known real-estate economist and Chicago housing coordinator, had this to say on the subject in his testimony before the Housing Subcommittee of the House Banking and Currency Committee:

"The second recommendation I would like to make is that some provision in the income-tax law be made for the mutual ownership of property without the mutual ownership being taxed as a corporation. There are millions of investors in the United States today who would like to buy a piece of the ownership of a building, that is, they would like to take a look at a nice building, and they would like to buy a thousand-dollar certificate of beneficial interest, or a $500 certificate of beneficial interest, but if this building today earns about 9 percent, which would be considered very good earnings, and this certificate of beneficial interest is taxed as a corporation, and the Government takes off 52 percent immediately, the yield, then, becomes noncompetitive, and one of the reasons why fortunes are channeling into the stock market, and fortunes are channeling into other mediums of investment in the United States, is because it is impossible for people to own this property mutually without their being taxed as a corporation and taxed out of half of their net.

"I think that if we could open up a mutual fund for the ownership of real estate in which each person would own one one-hundredth, or one-thousandth of a piece of real estate, I think all could be held free and clear without mortgages. We would channel really billions of dollars of money into real estate."

We sincerely believe that steady economic growth can be achieved by the removal of tax discriminations which impede the flow of risk capital to the area of rental housing, which today is truly the sick child of an industry already nursing an 8-year low level of activity while demand for housing increases.

Last year the Congress sought to correct this discrimination by approving the bill, H. R. 4392, which would have extended to the real estate investment trust the conduit theory applicable to security investment trusts. Unfortunately, the President vetoed the measure upon the recommendation of the Treasury, although we must doubt that the arguments against the measure as set forth in the President's memorandum of disapproval will stand up under critical analysis. It is to be noted, for example, that the memorandum of disapproval makes no reference whatever to the following statement by the Ways and Means Committee and the Senate Finance Committee in their reports on H. R. 4392:

"In addition to providing equality of tax treatment between the trust beneficiaries and the investment-company shareholders, your committee believes it is also desirable to remove taxation to the extent possible as a factor in determining the relative size of investments in stock and securities, on one hand, and real estate equities and mortgages, on the other. This is particularly important at the present time because of the country-wide complaints about the shortage of private capital and mortgage money for individual homes, apartment houses, office buildings, factories, and hotels. At the present time, the financing of these real-estate equities and mortgages is dependent largely on Government-guaranteed money and investments by special groups, such as insurance companies and pension trusts" (H. Rept. 2842, p. 4, and S. Rept. 2797, p. 2, 84th Cong., 2d sess.).

Two bills have been introduced in the House and one in the Senate at the present session to accomplish the same ends as H. R. 4392; namely, H. R. 3780, by Representative Keogh, of New York; H. R. 3868, by Representative Simpson, of Pennsylvania; and S. 1876, by Senator Flanders, of Vermont.

We are hopeful that the Congress will again review this legislation and resubmit the measure to the President. Removal of discriminations such as this, which seriously affect the flow of investment capital into vital sectors of the economy, should precede consideration of general tax reduction.

Senator O'MAHONEY. The next hearing of the committee will be on Thursday, June 13, 1957, at 2 o'clock in the afternoon in the House caucus room, 362 Old House Office Building.

Mr. Percival F. Brundage, Director of the Bureau of the Budget, will be the witness. He will be the only witness on the 13th. That will be followed on the following day by Secretary of the Treasury Humphrey and by Mr. William McC. Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System.

Thank you very much, gentlemen.

The committee is adjourned until the next meeting.

(Whereupon, the committee was recessed, to reconvene at 2 p. m., Thursday, June 13, 1957.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

THURSDAY, JUNE 13, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 2 p. m., pursuant to recess, in the main caucus room, Old House Office Building, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Representative Mills (chairman of the subcommittee), Senators Douglas and O'Mahoney, and Representative Curtis.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy; John W. Lehman, acting executive director; and Hamilton D. Gewehr, research assistant.

Representative MILLS. The subcommittee will come to order, please.

Today the Subcommittee on Fiscal Policy of the Joint Economic Committee resumes its inquiry into the fiscal policy implications of the economic outlook and budget developments.

Our purpose in these hearings is to examine the facts concerning current and prospective economic and budget developments upon which sound responsible fiscal policy consistent with the economic growth and stabilization objectives of the Employment Act should be based.

We are privileged to have with us this afternoon, Mr. Percival F. Brundage, Director, Bureau of the Budget.

Mr. Brundage, we want to thank you for taking time off from a very busy schedule to be with us and to help us in our analysis of current and prospective budget developments.

STATEMENT OF PERCIVAL F. BRUNDAGE, DIRECTOR, BUREAU OF THE BUDGET

Mr. BRUNDAGE. Mr. Chairman and members of the committee, it is a real pleasure to have the opportunity to discuss current budget developments and fiscal policy. I have a summary statement, and will be glad to try to answer your questions.

Regarding the fiscal year 1957, the current year has only a little over 2 weeks to run, but preliminary budget figures for the year will not be available until the latter part of July. Insofar as we can tell at this time, the total budget receipts are likely to be fairly close to the budget estimates—perhaps a hundred million either way. I hate to talk this way. From my previous experience, a hundred million is a lot of money, but when you are dealing with Government receipts, if you can estimate that close you are doing awfully well. And budget expenditures are now estimated to be approximately one-half billion dollars more than the figures in the January budget.

On the expenditure side, Department of Defense costs are running substantially higher than was estimated in January. Most of the increase is in the Air Force, reflecting largely the acceleration of our ballistic-missile programs and higher rates of aircraft procurement than previously anticipated. In addition, the lead time has been shortened and payments to contractors have been accelerated. Deliveries under the military portion of the mutual security program are below the amount anticipated in January, but it now appears that national security expenditures as a whole will be considerably higher than our January estimates.

Current indications are that there will be partially offsetting decreases in some of the nondefense programs. For example, it now seems likely that net budget expenditures for the Federal National Mortgage Association will be much lower than we anticipated in January, since secondary mortgage market operations have been financed through the sale of debentures to the public to a greater extent than had been estimated (with a consequent reduction in borrowing from the Treasury and in net budget expenditures). Net expenditures by the Export-Import Bank will also be substantially lower than estimated, since the United Kingdom has not drawn down anything on its line of credit, for which provision had been made in the January budget. The Commodity Credit Corporation's net expenditures for regular operations will be higher than anticipated in January, but this increase will be more than offset by a reduction in the soil-bank program.

On balance, it looks as though the total of budget expenditures in the fiscal year 1957 will be higher than had been estimated in January. An upward revision, I see, was forecast by the staff of your committee as well as the staff of the Joint Committee on Internal Revenue Taxation.

Part of the incerase in our expenditures is due to the so-called cost push about which economists have already testified before your committee. I am inclined to agree with those who stated that the increases in cost due to the rises in wages and prices that occurred last summer are more largely responsible for the increase in the Consumer Price Index and wholesale prices generally than increases in demand. The Government can do only so much in holding down inflationary pressures. We must count on full support from private industry. We are so largely affected by what industry does both in wage and price determinations. We certainly don't want the Government to start getting into various businesses again. On the contrary, it has been our constant effort to dispose of our manufacturing and service operations that compete with private business.

The demands of our economy and of national security are so great that we are faced with big decisions every year as to how to hold down and reduce expenditures and still obtain the security and the services we need. We are certainly not trying to spend money in order to find reasons to keep high taxes, as we have been accused of doing. We did make substantial reductions the first 2 years until wage and price increases and program needs turned the trend the other way. We are now trying our best to hold to the current level and trying to find funds for new programs and growing programs out of reductions elsewhere.

Last week I spent a couple of days on the U. S. S. *Saratoga* and had the opportunity to see how our money was being spent in building and operating an aircraft carrier and an aircraft task force. It was the first time that I have taken time out to really see the operations, and it was very revealing. I was impressed again with the marvelous number of new ideas that have been incorporated into its design and operation, and yet the officers in all of their briefing continually emphasized further improvements and still newer developments that they were working on. We have a large assortment of new weapons, and I saw some of them demonstrated, but we are continually working on improvements and new ideas. The difficult decisions with which we are constantly faced in trying to control expenditures in this area I am sure are easily understandable to members of this committee.

In spite of our incerased expenditures for defense, however, I believe that we will be able to end the fiscal year 1957 with a substantial budget surplus, although a smaller one than the $1.7 billion estimated last January. We expect, of course, to use this surplus to make another reduction in the public debt.

At present, the economy is operating at a very high rate. Gross national product, employment, and income reached new alltime highs in calendar year 1956, and further rises are generally predicted for the current calendar year. For a year now, as I just mentioned, we have also been witnessing an upward rise in prices after several years of relative stability. In this period of intensive competition for economic resources, clearly the Government should not add to these inflationary pressures beyond making adequate provision for national security and for essential civilian services. We have been directing our fiscal policy toward that objective.

An important element of this policy is to keep Federal expenditures within income. In January we anticipated a budgetary surplus for the fiscal year 1958 as well as for the current fiscal year. These surpluses would add to the restraining effects of present monetary and credit policies. To make the budget surpluses and debt reductions possible, the President recommended in the budget, and the Congress has since enacted, legislation to extend existing excise and corporation tax rates.

Another element of our fiscal policy is to keep expenditures down wherever possible in order to avoid increasing the Government's demands on the economy. Even though budget expenditures in the fiscal year 1958 were estimated in the January budget to rise dollarwise, they would amount to but 16 percent of the gross national product as compared to over 20 percent 4 years ago. Nevertheless, as the President pointed out in the budget message in January, he has asked each agency head to postpone construction work wherever possible in view of the current active competition for labor, materials, and equipment, and to continue every effort to prevent increases in Government personnel. He also said in the budget message that efforts would continue to be made throughout the Government to hold expenditures in the fiscal year 1958 well within the estimates contained in the budget.

In line with the instruction from the President, a review of the budget has been made which indicated the possibility of reducing obligational authority for the fiscal year 1958 by $1.8 billion, as outlined in the President's letter of April 18 to the Speaker of the House of Representatives. The resulting expenditure reductions in 1958, however, will be nothing like that amount. We intend to continue searching for additional economies, savings, or deferments of expenditures.

The Congress, as you know, has made additional reductions in new obligational authority, but is also proposing increases, and has not as yet acted on the bulk of the appropriations and other authorizations recommended in the budget for 1958.

The 1958 results will depend a good deal on the actions of Congress from now on. I refer to such things as the postal rate increase which I consider to be very important. The increased volume of business in that Department will add to our difficulties in 1958 unless we obtain a substantial rate increase or can put the Post Office on a regular working fund self-supporting basis. This would place authority in the Postmaster General to fix rates after consulting an advisory committee. It seems to me that this is the only sound way of operating the Department.

Another matter of concern is the proposed increase in the borrowing authority for the housing agency. I hope we will not stimulate the market unduly to construct beyond the demand of new families and cause us future trouble.

Congress can also help us in holding down the authorizations and funds for new Corps of Engineers and Bureau of Reclamation starts to really urgent projects and in not pushing the older projects but allowing us to spread them out at economic construction rates over a longer period, to minimize the effect of Government competition in that active industry. We have been bidding against ourselves and adding to the cost of all of our projects.

When congressional action in this session is completed, the Bureau of the Budget will make its annual midyear review taking into account the enacted legislation and other factors which affect the 1958 budget figures. This will be issued around the first of September.

I am sure that Members of Congress realize how hard it is to reduce expenditures once obligational authority has been granted and plans for expenditures have been made. There are so many long lead-time items, particularly in defense. It is the other way around with increases, however. The additional $900 million obligational authority added by Congress to our defense budget request last year had an important part in the increased expenditures in fiscal 1957. It has made it more difficult for us to hold down the expansive plans of all the services.

The staff of the Joint Economic Committee has estimated that expenditures in 1958 will be $1 billion to $1.5 billion greater than we estimated last January. Staff of the Joint Committee on Internal Revenue Taxation has estimated that budget expenditures in 1958 will be $1.2 billion more than the January budget estimate. I understand that similar testimony was given before this committee last week.

These upward revisions are based in large part on the increased rate of Department of Defense expenditures during the past 2 or 3 months and the fact that price increases have occurred since the original estimates were made. I believe it is somewhat premature to accept this conclusion, as we are making the most strenuous efforts to make savings wherever possible. The accelerated procurement in defense this year anticipated expenditures planned for 1958 and 1959 so that some offsetting reductions should be possible.

I note that in its hearings last week this committee expressed interest in the outlook for budget expenditures in the fiscal year 1959, and heard testimony to the effect that 1959 spending would probably be substantially above the 1958 level. Of course, the Bureau of the Budget is only in the early stages of work on the 1959 budget and no firm estimates are as yet possible. A large part of the 1959 expenditures will come from appropriations and other commitments made prior to that year, and while an increase in spending cannot be ruled out, I certainly hope it will not occur, and am taking all possible steps to prevent it.

An improvement in the international situation could affect the budget substantially. Even without such improvement, success in the strenuous efforts within the administration to make each dollar go further should help us to hold the line. We are working hard to increase efficiency in the defense programs and to make all possible savings in other programs. Helpful congressional action along the lines I have already indicated together with our own efforts should produce another budget surplus for fiscal 1959.

For the present, I believe that our major fiscal objective should be to maintain a budget surplus and continue reductions in the public debt, with reductions in the present high tax rates only when our budget surplus and the economic outlook justify them. I hope it may be possible to consider some tax reductions effective for part at least of 1959 but this is going to depend on economies in every area and the full cooperation of the Congress.

Therefore, while I favor tax reductions when they can be made as part of a sound fiscal policy, I believe that it is more urgent at this time to have a balanced budget and debt reduction.

The Government must do its part in fostering economic growth without disturbing stability, but in our free enterprise system all segments of our economy must participate to achieve this goal.

Representative MILLS. Thank you, Mr. Brundage, for your statement.

Mr. Brundage, I wonder if you would tell us how the cash budget surplus in calendar year 1957 compares with the $5½ billion in calendar year 1956?

Mr. BRUNDAGE. The cash surplus?

Representative MILLS. Yes, your cash budget surplus.

Mr. BRUNDAGE. I have not made a new estimate. It should be somewhat less than the 1956 figure.

Mr. COHN (Samuel M. Cohn, Chief of Fiscal Analysis, Office of Budget Review, Bureau of the Budget). You asked calendar year, Mr. Chairman, and we do not have any calendar year estimates.

Representative CURTIS. For the benefit of the record, would you identify yourself?

Mr. COHN. Yes. I am Samuel Cohn, Chief of Fiscal Analysis, in the Bureau of the Budget.

In the fiscal year 1957, we would expect the consolidated cash surplus to be in the neighborhood of $2½ billion, compared with three and a half that we estimated in January. The various changes in expenditures, the half a billion dollar increase in expenditures, that Mr. Brundage referred to in the budget, carries over to the cash budget, with the exception of the Federal National Mortgage Association change.

This financing from agency borrowing is an expenditure in the cash budget, but not in the administrative budget. And that accounts for the additional half billion dollars, roughly. So that you have a decrease in the cash surplus of about a billion dollars from the January estimate compared with a half a billion roughly in the administrative budget.

Representative MILLS. Several of our witnesses last week, Mr. Brundage, maintained that even if no additions whatever are made to existing Federal spending programs, total Federal expenditures are likely to continue to increase through the next couple of years, as you noted in your statement, both because several of these programs have expansion built into them and because of increasing prices and costs.

Are you in a position to give us some rough measures of these factors in our problem of keeping Government spending under control?

Mr. BRUNDAGE. This is quite true. If we made no positive effort to limit them, I would expect them to go up about $3 billion a year. Just the built-in factors, you might say. But we are making very positive efforts to limit them, and I hope we will be successful.

Representative MILLS. I am interested in that. I think you are probably correct in your estimates. As I have gathered from other sources, it will take some positive action, or these existing programs of today will increase by about $3 billion.

Now, you have sought in your statement the cooperation of the Congress in trying to hold these expenditures down and not have them rise as they will, without some positive action.

What can the Congress do, other than what you have already pointed out, through positive action, to prevent these rises from occurring or to assist the administration, through the use of whatever power it already has, to prevent these increases from occurring?

Now, we are talking about Congress not making any additions to existing programs. But just on the basis of the programs that we have today, if we do not take some positive action with respect to these elements that already are causing or tending to cause these increases, these increases will occur.

Now, what else can the Congress do to be of assistance in the way of positive action to prevent these rises from occuring?

Mr. BRUNDAGE. Well, I mentioned a few things. I think an item veto would be helpful.

Representative MILLS. You testified before the Judiciary Committee as I recall in favor of the item veto.

Mr. BRUNDAGE. It seems to me it is not only what the President might veto, but the fact that there was a veto, I think, might help in holding the line on less desirable and less urgent projects.

Representative MILLS. Now, I do not want to be misunderstood, Mr. Brundage. I am talking about what the Congress can do to help to hold down these increasing costs with respect to existing programs for which we have a commitment.

Now, I do not know that the veto or the item veto would help so much in that regard. It might prevent the additions of new programs or phases of new programs, or the enlargement of some existing program through extension of service in some way. But what I am talking about now is the point that was made by so many witnesses last week, that even if we make no such additions, there are so many of these built-in growth features and prices and costs are going up at such a rate that we can expect the cost of existing programs to rise approximately $3 billion a year as our economy continues to rise.

Now, is there anything, actually, through positive action or otherwise, that the Congress or the administration can do—and if so, what is it that we can do—to prevent the cost of these existing programs from going up as our economy expands?

Mr. BRUNDAGE. Well, I can think of a number of things.

The question of the whole agriculture program, I think, needs a new look. I think Secretary Benson has written Senator Ellender proposing some rather complete and radical reexamination of the whole philosophy. I know I have had a number of farmers come to me and remark that they wish that we had not interfered; that they would be better off today. And I think it is appropriate to have a new look at that program. Possibly as a result of the Bradley Commission report, it might be a good thing to look at the veterans programs again. I think that there are a lot of installations that the Defense Department feels are no longer necessary. Our whole plan of defense, our whole weapon system, have changed, and I believe there are a number of installations that could be closed down and terminated. We could save money that way. That type of thing would be helpful if the Congress would support and not oppose termination of some of those projects.

Representative MILLS. Mr. Brundage, I am not attempting in any way to do anything except adduce information from you. We have no desire whatsoever to criticize you. We realize the tremendous job you have in trying to keep expenditures within the estimates made 6 months or a year ago, when the price of things continues to rise. I have almost reached the conclusion—I wonder if I am wrong—that if we are to hold Federal spending in fiscal 1958 and 1959 to the level estimated in the January 1957 budget message, it will be necessary for us really to cut into existing programs and not add any new programs.

Mr. BRUNDAGE. I think that is right.

Representative MILLS. If we do not cut into the existing programs, although we do not add any additional programs, and if we do not provide some better administration or management of the programs in some way that none of us have yet developed, then we can anticipate a rise in the cost of existing programs for fiscal year 1958 and 1959 over the estimates of January 1957, can we not?

Mr. BRUNDAGE. Well, you are referring to the estimated $71.8 of expenditures?

Representative MILLS. Yes. That is the estimate, of course, for the cost of operating these programs in the 1958 fiscal year. But you have said, and I think the others have agreed, that on the basis of existing growth features and the existing economic situation, we can expect a rise in the cost of existing programs at the rate of about $3 billion a year.

Now, maybe we can make some economies somewhere along the line that offset that. But my question is, Am I correct that they can be made and probably can only be made as a result of cutting into existing programs and reducing existing programs?

Mr. BRUNDAGE. We will have to cut into some of our plans. Actually, our spending level for 1957 will be something under $70 billion. And if we do get the departments, the operating departments, and the Congress to accept that as a reasonable level, I think with shifts to take care of newer developments and things that became necessary, and cutting down on older programs, we would certainly be able to cut down on the rate of increase substantially.

One of the most difficult things in starting a new program is to terminate something else to offset it. Because the termination is blocked by everybody, blocked by the Department, blocked by the people, and it is blocked by the Congress. Opposition is inevitable, it seems.

Representative MILLS. But I am trying to establish this point, on which I think you would agree with me completely; namely, if the administration and the Congress are to do what you and I would assume is the majority thinking in the United States, namely, reduce expenditures of Government in fiscal 1958 and fiscal 1959, in order to provide even as you suggest some tax reduction in some part of 1959—that is fiscal 1959 you are talking about, I guess—then the people who want that done must recognize, if they do not already recognize, that our spending in those fiscal years—that is, for existing programs—is likely to be greater than what the President estimated in January those expenditures would be, unless the administration and the Congress can succeed with the support of the American people in bringing about a reduction of those existing programs that we have today.

Mr. BRUNDAGE. Very true.

Representative MILLS. In real terms.

Mr. BRUNDAGE. Yes; that is true.

Representative MILLS. That means, then, that the Congress, in order to reduce spending, is not going to accomplish its objective by merely working toward reducing budget figures in appropriation bills, but that the Congress must go back, as you have suggested, with respect to the agricultural program and some other programs, and reevaluate those programs, and see if we want the cost that is involved in those programs, or how we can reduce that cost by changing those programs. Is that not true?

Mr. BRUNDAGE. I would agree with you.

Representative MILLS. So if we are to do, then, what the American people presumably want done, namely, reduce the costs of Government, we must pay more attention to the basic authorization supporting existing programs and do something about those authorizations?

Mr. BRUNDAGE. Very true.

Representative MILLS. Fine. Thank you, sir.

Mr. Curtis?

Representative CURTIS. Mr. Brundage, you mentioned, at the bottom of page 2, that the $1.7 billion surplus, or whatever it will be, would be "used to make another reduction in the public debt." In what area of the public debt would this reduction be made?

Mr. BRUNDAGE. I suppose it would be in failing to refinance all of the maturities as they come due.

Representative CURTIS. Would it be a particular kind of maturity that would be the emphasis? Are there any plans along that line?

In other words, that is exactly what I meant. In other words, that kind of public debt would tend to be refinanced, and what would not? Where would this surplus be applied?

Mr. BRUNDAGE. That would be handled by the Treasury, and I think you would probably get some correct information from the Secretary. I do not know about that.

Representative CURTIS. You do not know what that policy would be?

Mr. BRUNDAGE. No.

Representative CURTIS. Now, I am going to try to get into this area of obligatory authorizations, which probably is a better way of considering what we are doing, what the Congress is doing, each time, in their budget.

Now, as I recall, simply to make this a complete picture, when this administration took over, the obligatory authorizations carried over were around $93 billion or somewhere around that area. Is that right?

Mr. BRUNDAGE. That is correct.

Representative CURTIS. Where do we stand so far as the carryover of obligatory authority is concerned?

Mr. BRUNDAGE. I think it is in the seventies.

Do you have the figure, Mr. Cohn?

Mr. COHN. We estimated that at the end of this fiscal year it would be $70 billion in total, compared to $94 billion at the end of the fiscal year 1954.

Representative CURTIS. Yes. Now, that could come about in either of two ways, accelerated expenditure, of course, or simply knocking off some of these carryovers.

Mr. BRUNDAGE. Rescinded or lapsed obligational authority; yes.

Representative CURTIS. Yes. Now, some of that knocking off of obligational authority can be done and has been done by the Executive without congressional action; is that not true?

Mr. BRUNDAGE. That is true; yes.

Representative CURTIS. Now, do you anticipate a continuation of the termination of some of these obligational authorities?

Mr. BRUNDAGE. Well, the greatest saving we could make I feel is by holding down requests for new authority in the 1959 budget.

Representative CURTIS. Yes, but you will always have something, particularly in the military, that the Congress has not appropriated money for, but for various reasons; maybe it was obsolete, maybe it was ill-conceived, but the program will not go ahead, and it is not the kind of thing where that money can be transferred to another program without congressional authority. Now, it is that termination that I am speaking of.

Mr. BRUNDAGE. We are working along those lines on the military public works construction right now. The appropriation bill has not come up yet.

Representative CURTIS. Well now, do you anticipate a continuation of the trend of lowering the amount of obligational authority that is outstanding? In other words, it has gone down from 94 to 70. Will that trend continue?

Mr. BRUNDAGE. Well, I would like to see it continue. I am going to try to make it continue. I cannot say that I can express an opinion on it.

Representative CURTIS. It will continue if you continue to increase the rate of expenditure, which you say is anticipated here. And you also state that by the anticipation of this rate of expenditure increasing in this fiscal year, some of the estimates that the increase will continue on into the next year are ill-founded. It is quite the other way around, that by the acceleration now, we might have a deceleration then.

Mr. BRUNDAGE. I would like to see the new obligational authority held below expenditures on a reduced basis. I think that is the way to get at it. And of course, this legislation before the Congress about putting appropriations on an expenditure basis, I think, would help also.

Representative CURTIS. I am glad to hear you say that. This is a personal statement.

We used to appropriate in that fashion, did we not?

Mr. BRUNDAGE. Yes, for some of the larger accounts.

Representative CURTIS. And there are many people who think that if we went back to that procedure, Congress itself would gain greater control. But we would accomplish the same thing, would we not, if we were to continue the trend of reducing the amount of carryover obligation?

Mr. BRUNDAGE. That is right.

Representative CURTIS. Now, in your projection, here, I gather that you presume that inflation will continue. In other words, our costs will continue to increase, and therefore that element is going to require more expenditures for the programs that we already have on the books. Do you anticipate a continuation of rising costs?

Mr. BRUNDAGE. We did not estimate a continued increase in our 1958 estimate. We assumed that same level would carry through the fiscal year 1958. Now, whether they do go up, I think, depends on industry as well as Government. That is why I emphasized the importance of teamwork on both sides.

Representative CURTIS. So from the standpoint of not aggravating this expenditure, it is important that inflation, if you can call it that, not continue.

Mr. BRUNDAGE. Very important.

Representative CURTIS. Mr. Mills was just pointing out that many of these price increases are built in. Well, they are to one extent, that certainly if the costs-of-living index rises, you are going to have further increased costs in some of your materials. But, on the other hand, if we can stop the inflation, I do not believe that we have too many built-in increased costs, do we?

Mr. BRUNDAGE. No. If we can hold the line on Government spending, even with increases in prices by industry this year, I think we could prevent the price level rising during the next 12 months. And that would be very helpful, of course, in holding the line on our spending.

Representative CURTIS. Mr. Brundage, I had a series of questions I wanted to ask on economies that might be achieved in supply management, particularly in the Department of Defense. This is an area in which I, beginning with my service on the Bonner committee, of the 82d Congress and even after, have been quite interested. I have had some figures computed that roughly the Department of Defense has personal property inventory worldwide of about $111 billion. Would you have any estimates on that?

Mr. BRUNDAGE. That would be a total of real and personal property?

Representative Curtis. No. This is just personal property, this estimate that I am giving, not real property.

Mr. BRUNDAGE. I would think that might be high for usable materials.

Representative CURTIS. I wonder if you would supply for the record what your estimate of that figure is.

(The information referred to follows:)

Summary of worldwide inventories, by type, Department of Defense, as of June 30, 1956

[Millions of dollars]

Type of property	Department of Defense	Army	Navy (including Marine Corps)	Air Force
Total	[1] 134,082	35,411	53,907	44,764
Real property	[2] 22,918	7,950	7,887	7,081
Personal property	[1] 111,164	27,461	46,020	37,683
Equipment and supplies in supply system	50,974	19,855	17,141	13,978
Military equipment	[1] 54,570	[1] 4,848	27,348	22,374
Production equipment	5,308	2,671	1,307	1,330
Industrial funds [3]	312	87	224	1

[1] Excludes personel property in the amount of $185.2 million under the jurisdiction of the Civil Works Division, Office, Chief of Engineers, Department of the Army. Includes $2,000,000 personal property of the Office of the Secretary of Defense.

[2] Excludes real property in the amount of $3,398,000,000 under the jurisdiction of the Civil Works Division, Office, Chief of Engineers, Department of the Army.

[3] Consists of raw materials, supplies, work in process, finished goods, excess, and salvage.

Source: p. 57 of report of Committee on Government Operations, 84th Cong., 2d sess., entitled: "Supplementary Real and Personal Property Inventory Report (Civilian and Military) of the United States Government located in the Continental United States, in the Territories, and Overseas as of June 30, 1956."

Representative CURTIS. Now, the figures I also have indicate that the supply system inventories of the various Departments of Defense amount to $51 billion. The real question I had in mind: Has the Bureau of the Budget studied the extent of duplication in these inventories? Have you made a study of that?

Mr. BRUNDAGE. We have worked on this matter, yes, in reviewing the report of the Hoover Commission task force, also in working with the Cooper committee of the Defense Department, and it is under constant survey. It is a terrific problem, because it is in about 2,000 locations, and it is very difficult. It is enormous.

Representative CURTIS. I think Admiral Fox told the Bonner subcommittee that there was about a 90 percent duplication as between the Army and the Navy. I am using that to illustrate how serious this might be.

Mr. BRUNDAGE. I think it is a serious problem. I do not think it is quite as bad as that. And I also think it is so large that we would probably have to break it down, even if it was entirely under single management, single procurement system. I think we would have to break it down very much like a big company, like General Motors breaks it down under their divisions.

Representative CURTIS. We also have a similar possibility of duplication between the military stocks and the GSA stores.

Mr. BRUNDAGE. That is true.

Representative CURTIS. This all leads to another estimate that I have received, that we have been generating in the Military Establishment primarily around $2 to $3 billion a year in surplus properties. Now, that is an annual rate. And, incidentally, we are getting about 8 cents on the dollar on this. If that is an annual rate, it certainly indicates that there is an area where a great deal can be done right along the line that Mr. Mills had asked the questions about, as to what might be done right now toward reducing this expenditure.

Mr. BRUNDAGE. It is a terrific problem. But that generation comes through newer developments, new purchases, new designs, new patterns, rendering old issues obsolete, you see.

Representative CURTIS. Well, Mr. Brundage, I would like to agree with you that that is entirely so.

Mr. BRUNDAGE. It is not entirely so.

Representative CURTIS. No, it is by no means entirely so. I have gone through an itemized list of this surplus property that is being generated, and you find in there such things as flashlight batteries and clothing. In fact, what I am mainly talking about is common use items.

Now, then, one other line of questioning, and I am done. And it is in regard to the military stock funds. They have inventories of about $10 billion and cash of about $2 billion. Is that about right?

Mr. BRUNDAGE. Yes, I would think the inventories are as large as that. The cash figure is under $1 billion.

Representative CURTIS. Now, it is also my understanding that the stock fund managers may not furnish stock to the usees unless they pay for it.

Mr. BRUNDAGE. That is the purpose of the stock fund.

Representative CURTIS. Then the users must get appropriations with which to buy the stock.

Mr. BRUNDAGE. That is correct.

Representative CURTIS. And this is regardless of how much stock might actually be on hand that would actually be surplus?

Mr. BRUNDAGE. That is true.

Representative CURTIS. Then is it not true that some of the stock that is in there is longtime and even excess supply in these stock funds?

Mr. BRUNDAGE. They are continually working to reduce these excess supplies, of course.

Representative CURTIS. Does it make sense that Congress should increase the obligation authority so that one agency could buy from another?

Mr. BRUNDAGE. Certainly not intentionally for that purpose.

Representative CURTIS. I do believe, though, the Bureau of the Budget started studies on this stock fund thing a couple of years ago. Have you made reports on those studies to Congress or anyone?

Mr. BRUNDAGE. We are working on it, and we have made our views known to Defense. I do not think we have made any report to Congress. It is a continuous process. We are also trying to put an accrual accounting system into all of the departments over there.

Representative CURTIS. Has the Bureau of the Budget taken any position relative to an integrated supply system for the Department of

Defense as required by the O'Mahoney amendment? I think that became law through a rider on an appropriation bill in the 82d Congress. Now, has anything been done by the Bureau of the Budget as to that?

Mr. BRUNDAGE. Yes. Part of our staff is working on it, and they have made some progress. It is very slow progress. I think if they do not go any faster it would take a generation. But they are doing something on it.

Representative CURTIS. Thank you very much.

Representative MILLS. Senator Douglas, you are recognized.

Senator DOUGLAS. Mr. Brundage, I was much interested in the third paragraph of your statement, on page 4, in which you said the Congress could help—

> in holding down the authorizations and funds for new Corps of Engineers and Bureau of Reclamation starts to really urgent projects and in not pushing the older projects but allowing us to spread them out at economic construction rates of a longer period.

Now, I most heartily agree with this, and ever since I came into the Senate I have been trying to do that, with very little success, I may say, and at the cost of making myself unpopular with a good many of my colleagues. And my head is bloody, even though it is a little bit unbowed.

Now, in the last attempt that I made to cut the 2 authorizations by a quarter, from $1,500 million to $1,125 million, a cut of about $375 million, among other objections I was faced with this objection: that it was not necessary to give the President added power to discontinue work on existing projects, to slow down work on existing projects, or to stop new projects, because, it was argued, he already had this power. And as a precedent, there was cited the action which I remember well; President Truman, in the summer of 1946, putting a stop order in on all river, harbor, and reclamation projects.

Have you any opinion on that, as to whether a new congressional authority is needed on the part of the President, or whether he can do this under his existing powers?

Mr. BRUNDAGE. I think that the new projects have to be approved by the Congress.

Senator DOUGLAS. But the work on existing projects? Can they be slowed down?

Mr. BRUNDAGE. I think that can be slowed down if we do not get pressured by everyone that has an interest in the project.

Senator DOUGLAS. You mean you want Congress to use intestinal fortitude rather than the administration?

Mr. BRUNDAGE. Both.

Senator DOUGLAS. But once the project has been authorized, once an appropriation has been made, does the President have any power as to the funds not to be expended?

Mr. BRUNDAGE. I think so. We can slow it down. But we do not want to slow it down below what we consider the economic construction rate.

Senator DOUGLAS. This is a very important point. I wonder if you would be willing to submit for the record a considered statement on just what the existing powers of the President are in connection with all of these types of work. That is not merely by type of work, but by those (a) authorized but not appropriated for, (b) those appropriated for but not started, (c) those appropriated and started.

Mr. BRUNDAGE. We cannot start one if it has been authorized but no money has been appropriated. We cannot start it.

Senator DOUGLAS. All right, then. Let us say (a) projects for which appropriations have been made but where work has not been started, and (b) projects for which appropriations have been made where work has been started.

(The statement referred to follows:)

The Director of the Bureau of the Budget, in apportioning funds for use by agencies in the executive branch, is authorized by law to establish reserves (sec. 3679, Revised Statutes, as amended, 31 U. S. C. 665). Funds which are reserved are not available for use by the agencies, and projects must be slowed down or stopped to the extent required by reserves established by the Director.

The Director's authority to establish reserves is specifically limited by the cited law, which provides that reserves may be established "to provide for contingencies, or to effect savings whenever savings are made possible by or through changes in requirements, greater efficiency of operations, or other developments subsequent to the date on which such appropriation was made available."

There is no law which specifically authorizes the President to stop or slow down projects. It would be extremely difficult to describe in advance the circumstances under which a President would be expected to take such action. It is assumed that the heads of the agencies in the executive branch would be guided by any requests made by the President in such matters.

The foregoing applies both to projects which have not been started and to projects on which work has already begun. Where work has already begun, there are additional factors to be considered, such as protection of work already in place and maintenance of an economic rate of progress on the work remaining to be done. However, there appears to be no difference in principle between the two situations.

Senator DOUGLAS. Now, the next question I wanted to ask is this: It deals with the relative validity of the so-called benefit-cost ratio. As you know, the Army engineers estimate the projected benefits from the project, and then the projected cost, and by dividing the first by the second it gets a ratio of benefits to cost. And if the ratio is above 1.0, then it is said to be desirable from a governmental point of view, and if it is less than 1.0 it is said not to be so desirable.

Now, I would like to ask you several questions in connection with this.

Has it been your experience that the Army engineers tend to overstate the future benefits?

Mr. BRUNDAGE. I would not say so as a general rule; no. I do not think that is true as a general rule. I think individual engineers in certain instances have. But as a rule, I think they try to do it very conscientiously.

Senator DOUGLAS. But if a navigation project is, for instance, carried out, then this is used as a club to force the railroads to reduce rates through the Interstate Commerce Commission; is that not true?

Mr. BRUNDAGE. I do not know of my own knowledge.

Senator DOUGLAS. I think that is true. And what happens is that the freight moves by rail as before, but at a lower rate. Now, is that a social advantage? Or does it mean that you put a burden upon the railroads which formerly did not exist?

Mr. BRUNDAGE. I think you have a definite point there. I think we have done that in several different forms of transportation, water transportation, roads——

Senator DOUGLAS. I wonder if you would be willing to make a considered statement for the record on the benefit feature of the benefit-cost ratio?

(The statement referred to follows:)

Unlike estimates of costs, estimates of probable benefits are seldom subject to exact future verification. Whether the benefit estimates are reasonable depends on the care with which all factors are considered and the kinds of assumptions adopted. The Chief of Engineers has issued directions as part of the Manual of Operations on the factors to be considered and the criteria and procedures for estimating benefits. From its experience in analyzing Corps of Engineers project reports, the Bureau of the Budget has concluded that in the main benefit calculations are reasonable.

Senator DOUGLAS. The second question I have is on the adequacy of cost estmates. I went into this matter some years ago, and I found that the actual costs on a series of completed projects were twice what the projected costs were. Have you made any study of actual costs as compared with the projected?

Mr. BRUNDAGE. Some of them have gone up very badly. The St. Lawrence seaway is an example.

Senator DOUGLAS. That is the most recent example?

Mr. BRUNDAGE. Yes.

Senator DOUGLAS. Can you tell us what the percentage increase in actual cost would be compared with the projected estimate of the Corps of Engineers on that?

Mr. BRUNDAGE. I do not know offhand; no.

Senator DOUGDAS. Would you be willing to make a statement for the record on that?

Mr. BRUNDAGE. I will; yes.

(The material referred to follows:)

Explanation of the increase in St. Lawrence seaway cost estimate

[In thousands]

Work program	Basic estimate, Corps of Engineers, December 1952 prices	Deferred and revised items	Basic planning and design changes, 1952 prices	Total project after planning and design changes, 1952 prices	Price escalation to July 1957	Added items 1956 prices	Total estimate, December 1956 prices
Lands and damages	$475		$2,725	$3,200	$711	$93	$4,004
Thousand Islands section	1,766		6,663	8,429	2,173		10,602
Long Sault canal and locks	64,370		−4,065	60,305	15,076	7,226	82,607
Point Rockway canal and locks	21,259	−$21,259					
Cornwall Island section			5,115	5,115	1,295	15,829	22,239
General-purpose facilities	204		−204			10,548	10,548
Corporation administration and field supervision						2,100	2,100
Mobilization operation and maintenance during construction						900	900
Corporation working capital	8,999	−1,999		7,000			7,000
Interest during construction	7,927	−7,927					
Total	105,000	−31,185	10,234	84,049	19,255	36,696	140,000

Senator DOUGLAS. I found, from the studies I have made, as I think I have said, that the actual costs were twice what the projected costs have been, which meant that if you had a benefit-cost ratio of 1 originally, it would only be 0.5 when the project was completed, assuming the benefits to be the same, and if you had a 2 ratio to begin with, it ultimately became only a 1. Would you be willing to have these projects reviewed and a comparison of the projected costs and the actual costs made?

Mr. BRUNDAGE. I will have a try, Senator.

Senator DOUGLAS. Thank you very much.

(The information referred to follows:)

INCREASED COSTS, CORPS OF ENGINEERS PROJECTS

The problem of increases in costs between the time Corps of Engineers projects are initially surveyed and authorized and the time they are finally completed is complex and has been studied several times in recent years. The House Appropriations Committee investigated the problem in 1951 (committee print dated August 16, 1951). The House Public Works Committee had the matter studied in 1952 (Jones subcommittee, House Committee Print No. 21, dated December 5, 1952). The Hoover Commission Task Force on Water Resources and Power reviewed the problem in 1955 (Task Force Report on Water Resources and Power, June 1955, vol. II, p. 809).

The Hoover Commission task force conclusions on the question were as followe (p. 811):

"This analysis led the task group to the following conclusions:

"1. For projects authorized by the flood-control acts enacted in 1944 and before, costs were quite generally underestimated, with the errors being particularly large for projects authorized in 1944.

"2. The initial cost estimates for projects authorized by the acts of 1946, 1948, 1949, and 1950 seem, in general, to be reasonably close to actual costs.

"3. The Corps of Engineers is, therefore, justified in claiming that it has improved the accuracy of its initial estimates; although not correct in ascribing the errors brought to light by the Appropriations Committee investigation largely to estimates made in 1939 or before.

"It is only fair to mention at this point that the Congress, in its haste to initiate a vast program of public works, overrode specific warnings of the Chief of Engineers that the plans authorized by the Flood Control Acts of 1936, 1937, and 1938 were in only preliminary form and that the cost estimates might be considerably in error."

The task force also summarized the causes for cost increases on the basis of the House Appropriations Committee investigations as follows:

Reasons for increase in estimated costs	Increase in estimated cost between time of authorization and time of study		
	Billions	Percent increase over original	Percent of total increase
Price changes	$1.89	71.6	57.7
Authorized project extensions	.57	21.8	17.6
Changed local needs or situations	.13	5.1	4.1
Structural and engineering modifications	.21	7.8	6.3
Unforeseen conditions	.28	10.6	8.5
Inadequacy	.19	7.1	5.8
Total	3.27	124.0	100.0

The House Public Works Subcommittee in 1952 selected seven projects to illustrate the problem of cost increases. The following table lists those projects with data contained in the subcommittee report to the House Committee on Public Works with an additional column giving latest cost estimates for those projects:

Changing cost estimates of selected projects

[In thousands]

Project	Survey report	After planning funds	After first construction funds	Fiscal year 1953	Latest estimate or actual cost
Buggs Island (John H. Kerr) Reservoir, N. C	$31,730	$57,730	$68,900	$84,860	[1] $87,150
McNary Dam, Oreg	49,470	130,735	227,028	281,650	[1] 285,000
Dalles Dam, Oreg	286,366	326,366	348,372	348,372	260,000
Garrison Reservoir, N. Dak	130,000	158,000	177,000	278,195	294,000
Fort Randall Reservoir, S. Dak	75,000	133,132	160,000	197,300	[1] 185,700
Oahe Reservoir, S. Dak	72,800	158,000	245,900	285,500	380,000
Chief Joseph Dam, Wash	104,000	206,000	206,000	206,000	150,000

[1] Completed.

Senator DOUGLAS. Now, the next question: Assuming the validity of this ratio in any event, assume that you have a benefit-cross ratio of 1.0. Do you think this is a desirable project to carry out? Does it not mean that the taxpayer is providing a direct subsidy to the private citizens who are benefited?

Mr. BRUNDAGE. I think it does involve that; yes.

Senator DOUGLAS. That is, it is a transfer from the taxpayers as a whole to this other group, and the sum of the benefits, with 1.0, will be equal to and not greater than the cost to the taxpayer?

Mr. BRUNDAGE. That is right.

Senator DOUGLAS. And in such event, unless there is a redistribution of the income, in which groups that need the money more than the average get the subsidies, there is no net gain in utility to the community; is that not true?

Mr. BRUNDAGE. If it does not go over 1.0.

Senator DOUGLAS. And the benefits, if they exist at all, are only in the surplus over 1.0; not in the 1.0 figure itself.

Mr. BRUNDAGE. That is correct.

Senator DOUGLAS. Now, there is another question I should like to raise. Are you in favor of varying the rate of construction on public works in a fashion designed to reduce the business cycle, namely, taper off construction in periods of rising prices and full employment and accelerate construction in periods of declining employment?

Mr. BRUNDAGE. I am; yes.

Senator DOUGLAS. Do you see how that can be implemented? How would you suggest implementing that project?

Mr. BRUNDAGE. It seems to be awfully difficult to apply.

Senator DOUGLAS. Well, can you help us?

Mr. BRUNDAGE. Well, we have tried to.

Senator DOUGLAS. How would you suggest that the Congress be of service in this respect?

Mr. BRUNDAGE. Well, we reduced our requests for construction in a number of agencies in the 1958 budget very drastically from their initial proposals.

Senator DOUGLAS. We authorize years in advance of work. We appropriate, and it will be some time before the work is begun. Economic conditions change in the meantime or may change during the period of construction itself, so that we never can anticipate with any degree of accuracy what the business cycle is going to be a year, 2 years, or 3 years in advance. Now, do you have any suggestions as to how the actual rate of construction and the actual rate of expenditure can be varied in a contracyclical fashion?

Mr. BRUNDAGE. One of the problems is that the very business activity that creates a peak generates a lot of urgent demand for these new construction programs, and it seems to be awfully hard to hold them down. We have definitely tried to do that, as the President has emphasized a number of times. I think we have been only partially successful. But I do think that with a little more education and understanding on the part of the public, they might accept it a little beter than they have.

Senator DOUGLAS. Would you think it would be desirable to have the President given added legislative authority and a general directive of policy that he should accelerate construction already authorized and appropriated for in periods of recession and decrease the rate of activity in periods of prosperity?

Mr. BRUNDAGE. Well, I think it might be helpful. The trouble with that is that as soon as anybody loses a job, they immediately think we are in a depression.

Senator DOUGLAS. I understand. But to have the executive given the authority to do this?

Mr. BRUNDAGE. It might be helpful to have a little discretion.

Senator DOUGLAS. Is there not also a tendency for an administration to refuse to admit that there is a recession when there is one actually in effect?

Mr. BRUNDAGE. I don't know about that.

Senator DOUGLAS. Secretary Folsom recently spoke of how the payment of social security had been of great aid in getting us out of the 1953–54 recession. This was from your colleague, Secretary Folsom. But at the time the administration was very vehement in denouncing anybody who said there was a recession. In other words, are you afraid that no administration would be willing to admit that there was a recession, and that, therefore, executive authority could not be depended upon to take action?

Mr. BRUNDAGE. I had not given any consideration to that.

Senator DOUGLAS. Would you prepare a memorandum on this subject, on the readiness of any administration to admit that there is a recession, and, therefore, to vary the rate of construction? Perhaps I ought to refer this to the psychiatrists and to the psychoanalysts rather than to the Budget.

Mr. BRUNDAGE. I think that is the toughest one of the lot.

(The statement referred to follows:)

Concerning the willingness of any administration to take actions to combat a recession, it is, of course, difficult to predict what any administration would do. However, the definite and deliberate actions taken by this administration in 1953 and 1954 to promote a stable prosperity are described on pages 18–20 of the economic report of the President transmitted to the Congress on January 20, 1955. The description concludes:

"What gave them [these recent actions] a special character was their promptness and the heavy reliance on monetary policies and tax reductions. The shift from credit restraint to credit ease before an economic decline had begun, the announcement of sizable tax reductions before it was generally appreciated that an economic decline was actually under way, the submission to the Congress of a comprehensive program for encouraging the growth of the economy through private enterprise—these early measures to build confidence were by far the most important. For they strengthened confidence when it was most needed, and thereby rendered unnecessary any later resort to drastic governmental programs to an atmosphere of emergency.

"The basic policy of the Government in dealing with the contraction was to stimulate business firms, consumers, and States and localities to increase their expenditures, rather than to expand existing Federal enterprises or initiate new spending programs. The success of this policy is evident in the present recovery.

Senator DOUGLAS. Now, one final question I would like to ask: Just as I was coming in, you mentioned the fact that you thought there were too many military installations over the country, and that if these could be reduced we would be able to effect appreciable economies without reducing national preparedness. I have felt the same way for a long time. I wonder if you have made any list of the installations which you have regarded as relatively superfluous. I am told we have a thousand military installations in the country.

Mr. BRUNDAGE. I don't personally have one in mind, but I think such a list might be prepared.

Senator DOUGLAS. Well, I would be most grateful for it. And I wondered if you would estimate what the savings would be by eliminating the installations which you regard as superfluous?

Mr. BRUNDAGE. I couldn't guarantee it would be all inclusive, but I can try it.

Senator DOUGLAS. I understand. It would be most helpful. When I was a young man I could remember the large number of forts which were maintained over the United States, with sometimes a company in every fort, and also the excessive number of naval stations maintained around our seaboard, such as Portsmouth, N. H., and Brooklyn, and Philadelphia, and Norfolk, and Charleston, S. C., and so on, where not more than two were needed for defense purposes. And as I look at the military installations over the country, it looks to me as though they were created for an Army of 13 million, and Army, Navy, Marine Corps, and Air Force of 13 million men. Now that numbers have shrunk to 2.8 million, or just about one-fifth, the number of military installations has certainly not diminished by a fifth. And then if you have to keep these military installations going, it involves breaking up the military forces into small units, which interferes with the tactical training of the troops. So that not only is this large number of military installations financially wasteful, but it actually decreased the tactical efficiency of our forces.

Mr. BRUNDAGE. I think it does; yes.

Senator DOUGLAS. Can you let us have that list before we start to debate the defense appropriations?

Mr. BRUNDAGE. I will do the best I can.

Senator DOUGLAS. Well, would you mind if we ride herd on you and telephone you from time to time asking for this list and the estimates of cost?

Mr. BRUNDAGE. Not at all.

Senator DOUGLAS. Thank you very much.

(Mr. Brundage subsequently submitted the following statement:)

Because the information requested has been classified by the Department of Defense, it is being supplied to Senator Douglas without insertion in the record.

Senator DOUGLAS. That is all, Mr. Chairman.

Representative MILLS. Senator O'Mahoney, we appreciate so much that you canceled your own hearing before your own committee in order to be here today.

You are recognized.

Senator O'MAHONEY. Mr. Brundage, I would like to address a few questions to you here. May I ask what the arrangements are now whereby the Bureau of the Budget participates with the various executive branches of the Government to come to an understanding of what appropriations will be asked for by the executive branch? How much influence do you have?

Mr. BRUNDAGE. Well, initially, Senator, we ask the agencies to submit their preliminary figures about a year ahead. We just have asked for the 1959 figures now. And those will come in and be assembled and will be presented to the President and to the Cabinet. There will be a general discussion, a rather detailed discussion, as to the conditions of the economy.

Senator O'HAHONEY. Does the Bureau present these figures to the Cabinet?

Mr. BRUNDAGE. Yes. I make the presentation.

Senator O'MAHONEY. And is that presentation made after you have examined the requests of the executive branches?

Mr. BRUNDAGE. Well, initially I put the figures together just the way they come to me. And those are the requests, the total requests, which usually add up to a pretty big figure. Then we have a discussion.

The chairman of the Council of Economic Advisers speaks about the condition, the anticipated economic condition in the ensuing year, or the year to be covered by the budget. The Treasury speaks about the tax estimate. And there is a good deal of discussion as to the total level of spending and in particular the types of programs that are going up.

Senator O'MAHONEY. The Council of Economic Advisers sits in on these discussions?

Mr. BRUNDAGE. Yes. It is represented.

Then we go back, and we go over these programs with each of the agencies individually, with the head of the agency and the staff, in the light of the discussion that we have had, and then we come up—we did last year, and I assume it will be something like that this year—with what we call a "ceiling" on the going programs and a "target" on the programs that are relatively uncontrollable through the budget process, like CCC and these other things that you can't exactly put a definite finger on, because they depend on what somebody else does, or other conditions.

Senator O'MAHONEY. Then the Bureau of the Budget fixes a ceiling, on which it gives those to the various departments and agencies?

Mr. BRUNDAGE. That is correct; the President, acting through the Bureau of the Budget.

Senator O'MAHONEY. Do you include all the agencies?

Mr. BRUNDAGE. Not all the agencies, only the largest spenders.

Senator O'MAHONEY. Do you include the commissions, which are exercising and delegating the authority of Congress?

Mr. BRUNDAGE. No. We included last year the 17 largest spending agencies. Of course, the estimates for Defense were developed with the President, the Joint Chiefs of Staff, and the Secretary of Defense.

Senator O'MAHONEY. Under whose signature is this served on the departments and agencies?

Mr. BRUNDAGE. Under mine.

Senator O'MAHONEY. Before you disclose the ceilings, do you discuss this with the President?

Mr. BRUNDAGE. As I said, "Yes." This is a result of the discussions we had with the President and the Cabinet and with the heads of the departments and agencies. It is a result of those discussions.

Senator O'MAHONEY. Well, that is a different situation from the one I had in mind when I questioned you. I gather from what you say that when you make your presentation to the Council of Economic Advisers, or, putting it another way, when you make your presentation to the President and the Cabinet, you have with you the Council of Economic Advisers, and the President is probably there, is he?

Mr. BRUNDAGE. That is right.

Senator O'MAHONEY. And then there is a general discussion, after which there is a goal set. Is that right?

Mr. BRUNDAGE. Well, there is a general discussion, and certain general policies are set, and then we go over it, as I say, individually.

Senator O'MAHONEY. And how are these policies set?

Mr. BRUNDAGE. They are set by the President and the Cabinet.

Senator O'MAHONEY. That is a matter of voting, is it? I am just trying to find out how much authority the Director of the Bureau of the Budget has.

Mr. BRUNDAGE. Well, I have only the authority designated by the President. He makes all these decisions.

Senator O'MAHONEY. Can you review the work of the various departments and agencies with respect to their observance of the ceilings that are imposed?

Mr. BRUNDAGE. Well, after these letters go out which I was describing, usually in July, then all of the agencies and departments submit their budgets to us. They are working on them during the summer and fall.

Senator O'MAHONEY. Are the recommendations contained in the budget now pending before the Congress, the recommendations, I mean, made by the various departments and agencies, below the ceiling which you would impose?

Mr. BRUNDAGE. Some of them are below, and some of them are above.

Senator O'MAHONEY. How did those which are above get to be above?

Mr. BRUNDAGE. Well, it is a rather long process. After we get these presentations and their justifications, then during the month of October and November we have hearings with each of the agencies, we go over each project, each of the figures, in considerable detail, and then we come up with agreement on a number of points and differences. And those differences are again taken to the President, and each one is resolved.

Senator O'MAHONEY. Now, is the budget that is now before the Congress——

Mr. BRUNDAGE. That is a combination as a result of these actions, sir.

Senator O'MAHONEY. Yes. But is it greater or less than the total of the ceilings that were first imposed?

Mr. BRUNDAGE. Oh, it is substantially less than the original proposal, about $13 billion less than the original proposals.

Senator O'MAHONEY. That is, the original request?

Mr. BRUNDAGE. That is right.

Senator O'MAHONEY. But how is it as to the ceilings?

Mr. BRUNDAGE. I think it is a little more than the ceilings. I don't know. My guess is that it is a little more than the ceilings.

Senator O'MAHONEY. What consideration do you give to the revenue which the Government is likely to receive? Has the Bureau of the Budget studied that, or do you accept the estimate of the Treasury Department?

Mr. BRUNDAGE. We make our own internal estimates, but we discuss them with the Treasury, and we accept their final estimate, which is the official figure.

Senator O'MAHONEY. Are you interested, therefore, in anything that affects revenue?

Mr. BRUNDAGE. Very definitely.

Senator O'MAHONEY. I ask that question because this morning, at a hearing of the Senate Subcommittee on Antitrust and Monopoly, the president of the Idaho Power Co. was discussing the tax amortization certificate that was issued to that company by the Office of Defense Mobilization against the recommendation of the Secretary of the Interior, Mr. Seaton. Have you made any study of the number of certificates of amortization that have been issued affecting this fiscal year?

Mr. BRUNDAGE. We keep track of it. I don't have it here with me.

Senator O'MAHONEY. And could you provide it for the committee?

Mr. BRUNDAGE. Yes.

Senator O'MAHONEY. In other words, let us know how much revenue the United States Treasury is losing by reason of existing rapid tax amortizations.

Mr. BRUNDAGE. Well, now, that is a little more difficult.

Senator O'MAHONEY. Well, what did you think I was asking for?

Mr. BRUNDAGE. I thought that you wanted the certificates that were issued this year. I could give you that. But the computation of the revenue that might be lost because of the certificates issued in the past would be very difficult to determine. The total certificates issued, I think, add up to over $30 billion.

Senator O'MAHONEY. Let us make it a little easier.

Mr. BRUNDAGE. Mr. Cohn thinks that the Treasury has a calculation of it, and perhaps you could get that from Secretary Humphrey tomorrow.

Senator O'MAHONEY. Would you do that, please?

Mr. BRUNDAGE. I will find out.

(The following table has been supplied by the Treasury Department, bringing up to date the table which appeared on page 234 of the Annual Report of the Secretary of the Treasury on the State of the Finances for the fiscal year ended June 30, 1955:)

Effect of allowance of emergency amortization certificates, based on certificates of $37,751 million issued through Apr. 17, 1957

[In millions of dollars]

Calendar year	Value[1]	Amount amortizable	Normal depreciation[2]		Accelerated amortization[3]	Excess of accelerated amortization over—		Decrease in tax liabilities[4]	
			Straight-line depreciation	Declining balances depreciation		Straight-line depreciation	Declining balance depreciation	Straight-line depreciation	Declining balance depreciation
1950	700	420	6	6	21	13	15	7	7
1951	4,167	2,500	87	87	292	205	205	113	113
1952	9,683	5,810	249	249	831	582	582	308	308
1953	15,570	9,340	455	455	1,515	1,060	1,060	583	583
1954	22,500	13,500	686	811	2,284	1,598	1,473	799	737
1955	27,500	16,500	901	1,209	2,979	2,078	1,770	1,039	885
1956	31,500	18,900	1,063	1,455	3,248	2,185	1,793	1,093	897
1957	34,500	20,700	1,189	1,600	3,129	1,940	1,529	970	765
1958	36,750	22,050	1,283	1,665	2,760	1,477	1,035	702	520
1959	37,731	22,790	1,346	1,658	2,200	854	542	384	244
1960	37,731	22,790	1,368	1,571	1,558	190	−13	86	−6
1961	37,751	22,790	1,368	1,450	1,018	−350	−432	−158	−194
1962	37,731	22,790	1,368	1,343	598	−770	−745	−346	−335
1963	37,731	22,790	1,368	1,246	283	−1,085	−963	−488	−433
1964	37,731	22,790	1,368	1,179	74	−1,294	−1,165	−582	−497
After 1964	37,751	22,790	8,685	6,806	0	−3,685	−6,806	−3,909	−3,064
Total			22,790	22,790	22,790	0	0	601	530

[1] End of year. These estimates are based on the ODM reported figures, but are modified in order to reconcile with corporate amortization deductions for 1951, 1952, and 1953.
[2] Straight-line depreciation rate assumed is 6 percent. Amounts shown for declining-balance depreciation assume that all certificate holders use this method for assets acquired after Dec. 31, 1953, switching to straight-line when it becomes advantageous.
[3] Figures for 1951, 1952, and 1953 are from Statistics of Income, pt. 2, others are estimated.
[4] Computations based on average effective tax rates reflecting rate decrease on July 1, 1958, scheduled under present law. Minus figures indicate tax liability increase.

Source: Office of the Secretary of the Treasury. Analysis Staff, Tax Division, May 1, 1957.

Senator O'MAHONEY. Now, of course, the theory of rapid tax amortization is that by reason of the 5-year provision, current taxes are reduced for the beneficiary, but it is assumed that future taxes will be increased, and that in future the repayment will be made. At a time, however, when you are trying to balance the budget—and Congress, of course, would like to help balance the budget—it is important to know, I think, precisely how much revenue is being lost for the present fiscal year by reason of outstanding tax amortization certificates. Then it would be interesting to know how many of these rapid amortization certificates have been extended to companies which do not have an actual defense aspect.

Now, how about your power to examine the contracts that are made by the pending authorities?

Mr. BRUNDAGE. We do not go into that ordinarily, unless there is some special occasion for it.

Senator O'MAHONEY. Well, I notice that you state in your prepared evidence here that most of the increase in the cost of running the Department of Defense reflects largely the acceleration of our ballistic missile programs and higher rates of aircraft procurement than previously anticipated. Is it not a fact that increasing prices will materiallly increase the cost of all defense construction and all reclamation construction and engineer construction?

Mr. BRUNDAGE. That is true, yes.

Senator O'MAHONEY. Do you examine that?

Mr. BRUNDAGE. No, not for each contract individually.

Senator O'MAHONEY. Do you not think it would be a good thing if the Bureau of the Budget were required to examine those things?

Mr. BRUNDAGE. Well, we don't have enough staff to examine every detail. You see, what we do is to analyze the expenditures by appropriations. And the appropriation for aircraft and related procurement was the one that showed the big increase. How much of that is due to price increase and how much is due to more rapid procurement of the items that were contracted for, we don't know exactly. But there are thousands of these individual items. I tried to make a guess at it, but couldn't.

Senator O'MAHONEY. It is a difficut field in which to depend on guesswork.

Mr. BRUNDAGE. Of course, this procurement is done all over the country, you understand. We couldn't do it here in Washington.

Senator O'MAHONEY. Do you make any effort to supervise the observance of the competitive bidding procedures required by law?

Mr. BRUNDAGE. No. No, that is the Comptroller General. We don't do any auditing at all.

Senator O'MAHONEY. Do you make any effort to become acquainted with the negotiated bids that are asked for?

Mr. BRUNDAGE. No. No, that is not one of our responsibilities.

Senator O'MAHONEY. Do you not think that that necessarily has a great effect on expenditures?

Mr. BRUNDAGE. There are a lot of things that do; yes, sir.

Senator O'MAHONEY. I remember there was submitted to the Government Operations Committee, I think in the last session of Congress, an interesting story about a call for bids on the construction of a wheat storehouse in Pakistan. This warehouse was to store wheat that this Government was contributing to Pakistan for the economic aid of the inhabitants of that nation. Bids were called for—competitive bids. When they were received, they were all rejected. And then the staff was ordered by the official in charge to negotiate the bid with one of the bidders who was not the high bidder or the low bidder and a bidder which had had less than a year's experience And then it was determined to grant the negotiated bid to this particular bidder, who had lost out in the competition. Fortunately, I think the committee was able to stop that. But if that is typical of some of the work that goes on in foreign aid, it might be well for the Bureau of the Budget to examine into it, don't you think?

Mr. BRUNDAGE. We would have to have quite a lot more staff than we have now, sir. If Congress considered it desirable, we could take it on. But it is my understanding that that is the kind of thing which the Comptroller General is supposed to cover. You see, he has a staff that is more than 10 times as large as ours.

Senator O'MAHONEY. Well, do you confer with the Comptroller General?

Mr. BRUNDAGE. We work very closely together on the accounting installations—that is, what we call the joint accounting program. But we ourselves do not go over this kind of thing in audit fashion, although the Bureau staff examines his reports very carefully.

Senator O'MAHONEY. I am trying to find out whether, in your judgment—since I suppose there is no agency that puts a ceiling on procurement budget, except perhaps the Congress, when you ask for appropriations—you might get a sufficient appropriation to obtain a staff that could do the job. I mean, which could enable you to perform the examinations of expenditures which would enable you to eliminate or help to eliminate waste and duplication in these expenditures. Do you think the work of the Comptroller General's Office is sufficient for that?

Mr. BRUNDAGE. Well, I think they are doing very good work. I think we could do more. As a matter of fact, my request for additional help was turned down by the Congress this year.

Senator O'MAHONEY. The Congress turned you down this year?

Mr. BRUNDAGE. Yes.

Senator O'MAHONEY. Have you had any occasion to look into the new national highways system? There has been a great deal of publicity recently about the effect of rising costs upon the cost of the new highways system. Have you gone into that?

Mr. BRUNDAGE. Well, I know that the costs have been going up, and that is why I emphasized the danger of our bidding against ourselves on these things. Because I have seen it in actual equipment that was wanted by the St. Lawrence seaway and in some reclamation projects and some corps projects. The price was bid up, and it was one of the reasons I asked for postponement, and deferring of some projects, which I got severely criticized for by one of the Congressmen.

Senator O'MAHONEY. One of the new national highway projects?

Mr. BRUNDAGE. It was one of the projects in New England, yes.

Senator O'MAHONEY. But under the new national highway system?

Mr. BRUNDAGE. Well, it involved the highway system and a corps project, both.

Senator O'MAHONEY. It struck me this year in examining the request of the Bureau of Public Roads that in the last fiscal year for which expenditures were definitely known, 1956, total expenditures by the Bureau of Public Roads were about $740 million. I noticed in the Budget in Brief which the Bureau of the Budget published—a very valuable document, by the way—that there was an appropriation of $44 million from the general fund of the Treasury for 1957 and $42 million or $40 million for 1958. And that led me to check into the special trust fund. And then it was revealed that the total appropriation for this year is well over a billion dollars.

Mr. BRUNDAGE. That is correct.

Senator O'MAHONEY. $1,090 million, I think, was the figure, if my memory serves me correctly. And the Bureau of the Budget sent up an approved estimate for a quarter of a billion dollars more than was expended in the last full year.

Mr. BRUNDAGE. That is about correct, yes. It was clearly identified in the budget document.

We had a number of conferences some time back to decide whether or not to include the highway program in the regular budget or treat it as a separate trust fund operation. And it was finally decided that because it would increase our surplus unjustifiably in the early years, we would treat it as a trust fund operation.

You see, the actual receipts in fiscal 1958 will substantially exceed the estimated expenditures in that year, which would have put our surplus, our estimated surplus, over $2 billion. But the trouble was that that amount could not be used for general purposes. You see, it was restricted to subsequent years' highway construction. So we thought it would be more misleading to include it than to take it out.

Senator O'MAHONEY. I cited this highway system merely as illustrative of the whole system. Because it occurs to me that the Bureau of the Budget, in making its preparations for submitting its requests to the Congress, takes care to go over the original requests of the various departments before they can be O. K.'d, discussing them in Cabinet sessions with the Council of Economic Advisers, and then, after putting a ceiling on the expenditures, getting the final estimates from the various departments and agencies.

It seems to me, then, that with so much preliminary work it might be very advisable for the Bureau of the Budget to continue close supervision of expenditures to guard against waste and extravagance and unnecessary increases.

Would you care to make any written comment to the committee, to be included in the record later on?

Mr. BRUNDAGE. If the Congress feels that way, I would certainly try to undertake it.

(The information referred to follows:)

While the Bureau of the Budget does not examine contracts or vouchers for expenditures, which is the responsibility of the General Accounting Office, we are working continuously to effect savings in the operations of the various departments and agencies.

When each appropriation bill becomes law, the Bureau of the Budget must apportion the appropriations and funds made available to the executive branch, with a relatively few exceptions. In doing so, the Bureau of the Budget normally makes a fresh review of agency programs and plans as they have been modified to take account of congressional action on the budget and changing circumstances since the budget was originally prepared. The apportionment system is intended to achieve the most effective and economical use of the funds available, and, for appropriations available for a definite period of time, to prevent the necessity for supplemental or deficiency appropriations. Apportionment requests and supporting material receive close scrutiny by the Budget Bureau in arriving at recommendations on the amounts to be apportioned.

Reserves may be established by the Bureau of the Budget in connection with the apportionment system. Amounts held in reserves may not be obligated by the agency, but may be released in whole or in part by further reapportionment action during the year.

Bureau of the Budget examiners make frequent visits to agency offices throughout the fiscal year. In addition to observing agency operations at headquarters, they regularly visit field installations to get a firsthand acquaintance with operations and problems. Although these visits do not usually result in formal reports and recommendations, they result in informal suggestions and discussions which in turn lead to improvements in agency management and operations.

The Bureau of the Budget on some occasions inspects agency records and as a regular recurring operation receives agency reports. These reports cover financial matters, and, wherever feasible they also relate to workload and program accomplishments. Such reports are not only used for further action on apportionments and reserves when appropriate, but may also provide the basis for inquiry, investigation, informal hearing, and other devices for reviewing operations and practices and effecting improvements from time to time.

Through cooperative arrangements with other agencies of the executive branch with central responsibilities, such as the Civil Service Commission and the General Services Administration, the Bureau of the Budget is apprised of possibilities of holding down or reducing obligations and expenditures in such fields as personnel management and property management.

The General Accounting Office furnishes the Bureau of the Budget with more than 200 written reports each year resulting from audit, investigation, and review activities of that Office as they pertain to executive branch agencies. Bureau of the Budget staff members review such reports and use them in their regular surveillance of agency operations and finances.

Senator O'MAHONEY. I would not want to take anything away from the General Accounting Office, nor to cause any overlapping or duplication of effort. But I think there ought to be the closest cooperation between the Bureau of the Budget and the General Accounting Office to make sure that there are not any leaks. You might be able to save some money that way.

Mr. BRUNDAGE. We exchange information very continuously, and work, as I say, very closely on our joint accounting program.

Senator O'MAHONEY. There is another question that I would like to ask you. I observe that in the budget in brief you made a comparison, a very informative comparison, of the expenditures made by all of the different agencies and the expenditures for different purposes. I was interested to see that interest on the national debt is estimated by the Bureau to amount to $7,400,000,000 for fiscal 1958, and that figure is $2,400,000,000 greater than the estimated expenditure for the Department of Agriculture and for the Veterans' Administration likewise. So that the most expensive item next to national security is interest on the national debt.

Mr. BRUNDAGE. That is correct.

Senator O'MAHONEY. The papers are full of stories of the difficulties the Treasury is encountering in selling or refinancing the obligations that fall due. So that it is very interesting to know that with the rising costs of materials there is no attempt to control inflation except the policy of the Federal Reserve Board. I wonder whether the Bureau of the Budget has given any thought to that or made any recommendations with respect to that?

Mr. BRUNDAGE. Well, we sit in the discussions with the Council and with the Treasury, but that is not our primary responsibility.

Senator O'MAHONEY. Oh, no, of course not.

Mr. BRUNDAGE. Sometimes I may offer my advice, but it isn't usually taken, anyway.

Senator O'MAHONEY. Well, there is one thing that I noticed, Mr. Chairman, in that budget in brief: that the expenditures for legislative and judicial functions constitute only a drop in the bucket. I started to say "a drop in the budget." That is true, is it not, Mr. Brundage?

Mr. BRUNDAGE. That is correct.

Senator O'MAHONEY. Congressional expenditures, franking privileges, and everything else, do not begin to compare with the expenditures of the executive agencies, any of them.

Mr. BRUNDAGE. Nor does the Bureau of the Budget either.

Senator O'MAHONEY. What is your total appropriation?

Mr. BRUNDAGE. Our total expenditures: the new authorizations are $4.4 million and the expenditures 4.375.

Senator O'MAHONEY. I beg your pardon? My attention was distracted by a telephone message. What is the figure?

Mr. BRUNDAGE. Our total new authorization requested was $4.4 million, and the expenditures 4.375. We were cut around $200,000.

Senator O'MAHONEY. So you are under $4 million.

Mr. BRUNDAGE. Just over $4 million.

Senator O'MAHONEY. Well, you are doing much better than the Congress, which is only about $200 million. But our expenditures for the Department of the Interior are many times that.

Mr. BRUNDAGE. That is correct.

Senator O'MAHONEY. And all of the other departments likewise. The Treasury Department, probably not as expensive as some of the others.

It might pe interesting for you to read that table of comparison. Do you have the table of expenditures in the back of that document?

Mr. BRUNDAGE. By departments?

Senator O'MAHONEY. That is right.

Mr. BRUNDAGE. These on page 50 are not actually by departments. They are by functions.

Senator O'MAHONEY. Mr. Chairman, I ask that there may be made part of the record at this point the table entitled "Expenditures and new obligational authority by agency (fiscal year 1958 estimate, in millions)." This appears on page 37 of the Federal budget in brief for 1958.

Representative MILLS. Without objection, it will be included at this point.

(The table referred to is as follows:)

Expenditures and new obligational authority, by agency

[Fiscal year 1958 estimate. In millions]

Agency	Gross expenditures	Public enterprise receipts	Net expenditures	New obligational authority
Legislative branch	$122		$122	$95
The judiciary	44		44	45
Executive Office of the President	12		12	12
Funds appropriated to the President:				
Mutual security	4,363	$6	4,356	4,400
Other	344	255	89	35
Independent offices:				
Atomic Energy Commission	2,340	(1)	2,340	2,520
Export-Import Bank	670	427	243	
Tennessee Valley Authority	310	282	27	45
Veterans' Administration	5,186	118	5,068	4,990
Other	728	112	616	799
General Services Administration	657	3	654	447
Housing and Home Finance Agency	1,937	1,546	391	1,194
Department of Agriculture	8,481	3,151	5,330	5,158
Department of Commerce	801	29	772	944
Department of Defense:				
Military functions	38,031	31	38,000	38,500
Civil functions	784	85	700	703
Department of Health, Education, and Welfare	2,834	3	2,831	3,071
Department of the Interior	737	32	704	718
Department of Justice	226		226	235
Department of Labor	422	4	418	438
Post Office Department	3,354	3,296	58	67
Department of State	330		230	230
Treasury Department	8,149	16	8,132	8,154
District of Columbia	43		43	42
Allowance for contingencies	400		400	500
Total	81,203	9,396	71,807	73,341

[1] Less than $500,000.

NOTE.—Detail may not add to totals because of rounding.

Senator O'MAHONEY. This table does not include the expenditures for legislation, but there is another table on page 33, on General Government. The total expenditure for General Government is estimated at $1,451 million. It is 2 percent of the 1958 budget, according to the calculation of the Bureau of the Budget.

Mr. BRUNDAGE. That is correct.

Senator O'MAHONEY. And this total amount is divided follows: Financial management, $519 million; property and records management, $307 million; FBI, alien control and related programs, $196 million; legislative and judicial functions, $152 million; central personnel costs, $104 million; District of Columbia, Territories, and possessions, $103 million; Weather Bureau and other, $70 million.

So that the legislative functions rank low in this tabulation.

Thank you very much, Mr. Brundage, and Mr. Chairman.

Representative MILLS. Thank you for being with us today, Senator.

Mr. Brundage, on page 5 of your opening statement, you concluded in part with this sentence:

> For the present, I believe that our major fiscal objectives should be to maintain a budget surplus and continue reductions in the public debt, with reductions in the present high tax rates only when our budget surplus and the economic outlook justify them.

Now, on last Friday, some of the witnesses maintained that in questions of tax changes and reductions, while we might give consideration to economic conditions and budget prospects, we should not give too much weight to short-run developments.

Do you think that we would be justified in undertaking some type of tax changes now which might result in revenue losses even if we were all convinced that these changes would be in the best interests of the economy over the long run?

Mr. BRUNDAGE. Well, I feel that at the present time, the economic outlook would indicate that tax reductions might add to the inflationary pressures. But if a downturn should come—and I assume that that is what you are addressing yourself to—I think we might decide that the long-run interests of the Government and the country would justify us considering tax reduction.

Representative MILLS. I raised the question, because I thought that these witnesses on Friday were suggesting these downward changes in taxes even though there is nothing in the economic picture that would indicate a downturn in economic activity. Their contention was, I think, that if we reduce taxes or make certain tax changes now, then that would promote economic growth over the long run and even though there would be an immediate loss in revenue if we did it, they were recommending that we do that.

Now, you have said that we should only reduce our present tax rates when our budget surplus and economic outlook justify them. And for the present you do not think that there is such justification?

Mr. BRUNDAGE. No; I don't. That is correct.

Representative MILLS. Then you carry on with this statement, that you hope it might be possible to consider some tax reductions effective for part, at least, of 1959. I think you mean fiscal year, do you not?

Mr. BRUNDAGE. That is correct.

Representative MILLS. "But this is going to depend on economies in every area and the full cooperation of the Congress."

Now, do you see any possibility, as we look ahead, that justifies tax reduction effective January 1, 1958, either enacted by this session of the Congress or enacted by the next session of the Congress, early in the year, with an effective date January 1, 1958?

Mr. BRUNDAGE. I don't; no.

Representative MILLS. So that you are taking care of the gap between the present and at least a part of 1959 in your conclusion.

Mr. BRUNDAGE. That is correct.

Representative MILLS. So that as you foresee this situation, the earliest possible date that we can expect to enact tax reduction and maintain responsible fiscal policy is some time with respect to fiscal year 1959.

Mr. BRUNDAGE. That is correct.

Representative MILLS. Thank you, sir.

Now, I want to allude again to this business of our cash expenditures. And I have before me a pamphlet prepared by the Research and Policy Committee of the Committee for Economic Development, called Tax Reduction and Tax Reform—When and How.

I was impressed with the increases that this table on page 12 reflects as having occurred between the fiscal year 1948 and the budget proposals for the fiscal year 1958, as I think in terms of what Congress can do to cut into existing programs in order to hold down spending in fiscal 1958 and fiscal 1959. This table shows that in fiscal 1948 we actually spent $36½ billion; that in fiscal 1958, according to the budget estimates, we proposed altogether to spend in cash by Government $83.6 billion, or $47.1 billion more.

Then in the breakdown, we find that $30.6 billion of that increase is attributable to major national security, as listed. Actually there is a decline of $2.4 billion in the spending between those 2 years for international affairs and finance. There is an increase of $8.7 billion between the 2 years for retirement and insurance trust funds. Then for all other functions of Government, for all of the other functions—there is an increase of $10.2 billion. And that $10.2 billion is further broken down, as I see it here, and the largest item, or almost half of that increase, is with respect to agriculture and agricultural resources. The increase in interest in actual cast payments is 1.6; highways, 1.4, and that is in billions.

Between those 3, we find 8.3 billion of the total 10.2 billion attributable to all other Government functions.

So it would appear, therefore, that if the Congress is to make reductions in existing programs in order to enable a reduction to occur in actual spending in fiscal 1958 or fiscal 1959, the Congress must find means of reducing the amount for major national security, the amount of expenditures from the retirement and insurance trust funds, the amount with respect to agriculture, the amount with respect to interest on the public debt, the amount with respect to highways, since those are the items which make up the bulk of this increase.

We are, of course, aware, all of us, of the fact that the President himself has suggested that we cannot, in the interest of national security, make much of a reduction, except of course to eliminate waste or extravagant management, perhaps, in the amount for major national security. And he has already advised us that we will run the risk of endangering our national security also if we cut international affairs and finance. Now, there is not any practical way, as I see it, for the Congress, upon review of the situation, to make reductions in retirement and insurance trust fund payments.

Mr. BRUNDAGE. No; that is right.

Representative MILLS. Perhaps a study of agricultural matters and the development of a new program might in some way reduce the expenditure for agriculture. The enlargement of foreign markets might do that, even if we do not do anything with our program.

There is not much we can do about the interest on the public debt, if anything. And I am sure that since the highway program has just begun, the Congress would not look with favor upon making a reduction there.

Would you agree to that?

Mr. BRUNDAGE. I think so; yes, sir.

Representative MILLS. It would appear, therefore, that though we have called attention to the fact that the Congress must, if expenditures are to be held to the estimates of January 1957—$71.8 billion—with respect to fiscal 1958, and if we are to hold expenditures within that limit for fiscal 1959, although we have said it will be necessary for the Congress to cut into some of these existing programs, the prospect for the Congress doing so upon further evaluation of them may not be too good.

Mr. BRUNDAGE. I think that may be true.

Representative MILLS. Thus, if we should adopt fiscal policy then which puts the cart before the horse, of prematurely reducing taxes upon the pretence that there will be reduction in these costs under the estimates contained in the budget of January 1957 for fiscal year 1958, it is entirely possible that we may wake up later on to the fact that we have actually unbalanced the budget for fiscal 1958; is that not true?

Mr. BRUNDAGE. It is true; yes, sir; in my opinion.

Representative MILLS. And in your opinion the operation of Government, on the basis of an unbalanced budget in fiscal 1958, will be responsible, or irresponsible?

Mr. BRUNDAGE. I think it would be very bad.

Representativet MILLS. Very bad; which might mean irresponsibility.

Mr. BRUNDAGE. I don't want to use that term.

Representative MILLS. I am not trying to press you into saying it, but at least it would not be responsible action.

Mr. BRUNDAGE. That is correct.

Representative MILLS. Thank you, sir. Without objection, I would like to insert the data on pages 12 and 45 from the CED report in the record at this point.

They will go in the record, then.

(The figures referred to are as follows:)

TABLE 2.—*Federal cash expenditures, by program, fiscal years 1948 and 1958*

[Billions of dollars]

Program	Fiscal years		Increase or decrease (—), 1948 to 1958
	1948 (actual)	1958 (proposed)	
Cash expenditures, total	$36.5	$83.6	$47.1
Major national security	13.0	43.6	30.6
International affairs and finance	5.6	[1] 3.1	−2.4
All other	18.0	36.9	18.9
Retirement and insurance trust funds	1.9	10.6	8.7
All other, excludes retirement and insurance trust funds	16.1	26.3	10.2
Agriculture and agricultural resources	.6	4.9	4.3
Interest	3.9	5.5	1.6
Highways	.4	1.7	1.4
Public assistance	.7	1.7	.9
Natural resources	.8	1.6	.8
Housing and community development	.2	.9	.7
Public education	.1	.5	.5
Public health	.1	.6	.4
Veterans services and benefits	6.9	5.6	−1.2
Other [2]	2.4	[3] 3.2	.8

[1] Includes the $200 million contingency fund for the Middle East.
[2] Due to a change in the method of handling the Government's payments to the Federal employees' retirement funds, "other" expenditures for 1958 are overstated, and all preceding categories of expenditures are understated, in comparison with 1948. See footnote 2, appendix table A, p. 45.
[3] Includes the prospective postal deficit at present postal rates.

NOTE.—Figures are rounded and will not necessarily add to totals.

Source: Appendix table A.

APPENDIX TABLE 9.—*Federal cash expenditures, by program, cash receipts, and surplus or deficit, fiscal years 1948–58*

[Millions of dollars]

Program	Fiscal years										
	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957 (estimated)	1958 (proposed)
Major national security	12,997	13,076	13,113	22,639	44,181	50,507	47,054	40,781	40,771	41,156	43,570
International affairs and finance	5,551	6,231	4,579	3,406	3,098	2,177	1,595	2,008	1,650	3,367	[1] 3,123
Retirement and insurance trust funds	1,881	2,486	3,368	3,057	3,815	4,580	6,063	7,467	8,062	9,250	10,550
Agriculture and agricultural resources	559	2,564	2,848	629	1,133	2,953	2,601	4,435	5,029	4,691	4,890
Interest	3,933	3,984	4,326	4,141	4,136	4,715	4,688	4,664	5,115	5,509	5,498
Highways	351	453	498	455	470	572	586	647	783	1,194	1,732
Public assistance	745	931	1,125	1,187	1,180	1,332	1,439	1,428	1,457	1,584	1,684
Natural resources	750	1,057	1,216	1,276	1,375	1,485	1,330	1,217	1,123	1,401	1,575
Housing and community development	220	17	221	861	259	381	−1,014	249	311	853	911
Public education	65	65	73	91	175	288	271	321	275	283	533
Public health	143	174	244	306	330	318	290	275	351	501	606
Veterans services and benefits	6,895	7,036	9,278	5,993	5,756	4,883	4,963	5,057	5,283	5,446	5,648
Other [2]	2,403	2,496	2,258	1,756	2,056	2,582	1,994	1,989	2,401	3,030	[3] 3,234
Cash expenditures, total	36,493	40,570	43,147	45,797	67,964	76,773	71,860	70,538	72,611	78,265	83,554
Cash receipts	45,357	41,576	40,940	53,390	68,013	71,499	71,627	67,836	77,084	81,720	[4] 86,123
Cash surplus or deficit (−)	8,864	1,006	−2,207	7,593	49	−5,274	−232	−2,702	4,473	3,455	2,569

[1] Includes the $200 million contingency fund for the Middle East.
[2] Beginning in 1958, the Government's payments to the Federal employees' retirement funds are allocated to the individual agencies and the correction to the cash basis is made in 1 lump sum as a deduction in arriving at the total for "other" expenditures. In prior years, both the payments to the funds and the correction to the cash basis were included in "other" expenditures. Accordingly, "other" expenditures are understated, and all preceding categories of expenditures are overstated, in comparison with prior years.
[3] Includes the prospective postal deficit at present postal rates.
[4] Adjusted to take into account the $200 million increase in tax receipts resulting from the postponement of the scheduled reduction in corporate income and excise tax rates until the end of fiscal year 1958.

NOTE.—Figures are rounded and will not necessarily add to totals.

Sources: The budget documents and supporting tables prepared by the Bureau of the Budget.

Representative CURTIS. Taking up the items Mr. Mills referred to, without in any way disagreeing on the line of questioning, because I happen to be very much in accord with that; the area of veterans benefits was one area where you thought there might be some reduction, and there has been an increase. Is that projected out as further decreasing, due to the fact that some of these things, like education, and so on, for the veterans, will be phasing out? Or how is that projected?

Mr. BRUNDAGE. Expenditures in 1948 were higher due entirely to special benefits after World War II GI benefits.

Representative CURTIS. So this figure 5.6, unless Congress did something, would remain about the same or might even increase?

Mr. BRUNDAGE. It is going up year by year as veterans get older and more of them become eligible for pensions.

Representative CURTIS. So that will be an increasing item rather than a decreasing item.

Mr. BRUNDAGE. That is right.

Representative CURTIS. How do you account for counterpart funds, for instance, in the international affairs and financing? Are the expenditures of counterpart funds listed as Federal cash expenditures?

Mr. COHN. It is only when the agencies purchase any funds for dollars that they appear in these figures. Expenditures in foreign currencies, by themselves, do not appear in the budget totals.

Representative CURTIS. Do the various agencies, in utilizing the counterpart funds, have to process them through your budgetary processing?

Mr. BRUNDAGE. Yes. They don't go into the budget totals, but they appear in special budget schedules and the agencies have to get our approval for the allocation, except for the congressional expenditures. We have nothing to say about that.

Representative CURTIS. Yes. Well, in spite of a lot of newspaper reporting, they are the insignificant portion of the expenditure of these funds, I might state. I have seen the comparison. But the reason I am drawing attention to that: In our disposal of agricultural products, in fact in a bill we recently considered, we are going to be generating several billion additional counterpart funds.

Mr. BRUNDAGE. The bill authorizes the CCC to sell at the world market price the agricultural commodities which are disposed of for foreign currencies and then the CCC takes the loss.

Representative CURTIS. But we gave authority, and they already have some authority along this line, to make a deal with the country that purchases these surpluses, by giving us a credit for counterpart funds. And those funds can be spent for the identical type things that are in the general subject matter of our national foreign aid programs. In fact, the programs—well, take the student exchange program. $18 million was coming through the regular budgetary requests, and I think something like $14 million is coming through this new counterpart setup. But that would not be reflected in these figures.

Mr. BRUNDAGE. Where it is transferred and becomes available to the Treasury and is in turn sold to the other agencies, it disappears from the foreign currency accounts and appears as a dollar expenditure in the regular accounts.

Representative CURTIS. Well, the case that I am giving you, for instance in the student exchange program—that would never reach the Treasury, as I understand it. Because that is immediately converted into counterpart funds that would be available in these various countries.

Mr. BRUNDAGE. It is a little complicated. When they use these foreign currencies for loans to the country, that does not appear.

Representative CURTIS. But these are not loans. These are actual outright grants. Many of them are outright grants, most of them.

Mr. BRUNDAGE. The country, I think, uses it.

Do you know about this, Sam?

Mr. COHN. I think Congressman Curtis is right, with respect to the Fulbright program, for example.

Representative CURTIS. I was just using that as an illustration. I did not want to use it as a bad illustration. I was familiar with that in detail. But I think the same thing goes if you were building a dam in some foreign country, where we generated counterpart funds. There are a number of purposes that have been listed for which these funds can be spent in the various countries, and it runs the gamut of the same type of expenditures that our Appropriations Committees consider in the foreign-aid bills.

Mr. COHN. I think that is right, sir. And we try to give them budget review just the same as if they were in dollars. But our regular dollar accounts do not show the transactions in the foreign currencies. That is right, sir.

Representative CURTIS. Do you keep, though, an account of how many dollars, or what is available, in the way of unspent counterpart funds?

Mr. BRUNDAGE. Yes. We do have that for all foreign currencies.

Representative CURTIS. Do you know what that amounts to now?

Mr. BRUNDAGE. Yes; we do. The latest figure will be available after the end of June.

Representative CURTIS. I would like to get that figure. And of course, without getting the actual figure, it is true that it is in the billions. Am I not correct there?

Mr. BRUNDAGE. That is right. Currencies on hand and expected are valued at over a billion dollars.

Representative CURTIS. And we will be generating billions more as this agricultural disposal program continues.

Mr. BRUNDAGE. That is correct, if you authorize another billion dollars.

Representative CURTIS. Now, just another detail, just to satisfy myself: Does the Bureau of the Budget recognize letters of intent, now, as sufficient authority to obligate funds? Do you understand a letter of intent? In other words, I am familiar with the military establishment. They used to be able, and as I understand it, it still has not changed, to simply write a letter to a contractor saying, "We intend to spend with you $2 million," and that was regarded for budgetary process as obligated money, although it was no contract but simply a letter of intent, as it was called. Now, I was wondering whether the Bureau of the Budget still permitted that practice.

Mr. BRUNDAGE. We get a report from Defense as to what they have obligated.

Representative CURTIS. And it could include, instead of a firm contract, a letter of intent?

Mr. BRUNDAGE. It could; yes.

Representative CURTIS. I would think that that would be an area that the Bureau of the Budget could profit by looking into. Because what is an obligated amount of money frequently turns out to be under a very peculiar kind of a contract. As I say, it used to be letter of intent, and I think it still exists.

Mr. BRUNDAGE. This came up recently in connection with the Air Force, and we took it up with the Secretary of Defense. He has issued this order, which I understand is being criticized right now, that they had to fund all of their orders. Because in that case, it was just the opposite. They would give an order for a certain number of items, but they would only obligate and fund a portion of it. So they really had an obligation which was not treated as obligated.

Representative CURTIS. I have one final question.

There was another process, and I think this still goes on, in fact I know it goes on. I just want to find out how much attention the Bureau of the Budget pays to it. That is the procedure of deobligating funds and then reobligating them. The military also developed that to a fine point.

Does the Bureau of the Budget watch that at all, to find out what might have been obligated previously, and then deobligate it for that purpose and then reobligate it somewhat at leisure?

Mr. BRUNDAGE. We watch it, and we are trying to get them put under the apportionment process. We are having discussions about it right now.

Representative CURTIS. I guess that comes up when they present their new budgets, does it not, when they show you what they have, what they have obligated, and what they might have spent?

Mr. BRUNDAGE. That is correct.

Representative MILLS. Mr. Brundage, we appreciate your appearance, and that of Mr. Cohn, and your fine cooperation and your help in giving us information here that will be of value to the committee as it proceeds. Thank you so much.

The subcommittee will adjourn until 10 in the morning, at which time the subcommittee will convene in this room.

(Whereupon, at 4 p. m., the hearing was adjourned until 10 a. m., Friday, June 14, 1957.)

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

FRIDAY, JUNE 14, 1957

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D. C.

The subcommittee met at 10 a. m., pursuant to recess in the main caucus room, Old House Office Building, Hon. Wilbur D. Mills (chairman of the subcommittee) presiding.

Present: Representatives Patman (chairman of the committee), Mills (chairman of the subcommittee) and Curtis.

Present also: Norman Ture, economist, Subcommittee on Fiscal Policy; John W. Lehman, acting executive director; and Hamilton D. Gewehr, research assistant.

Representative MILLS. The subcommittee will please come to order.

The Subcommittee on Fiscal Policy today concludes its hearings, on fiscal policy implications of the economic outlook and budget developments, with the appearance this morning of the Secretary of the Treasury, Mr. George M. Humphrey; and this afternoon, Mr. William McChesney Martin, Chairman of the Board of Governors of the Federal Reserve System.

The purpose of these hearings has been to subject the economic and Federal budget situation and prospects to careful scrutiny in order to determine the proper course of Federal fiscal policy in the coming months. We have approached this inquiry in the light of the Employment Act objectives of economic growth and stability. We are all aware of the great importance of Federal fiscal policy in providing the setting within which our enterprise economy can proceed on a steady and noninflationary course of economic growth.

Last week we had the benefit of testimony of 33 non-Government experts with respect to: (1) the current economic situation and prospects for the remainder of 1957; (2) the effect of current congressional and administration efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957–58; (3) types of fiscal action consistent with economic stability and growth if spending reductions are achieved; and (4) the timing of fiscal action in relation to budgetary and economic developments.

Yesterday afternoon we were privileged to have the testimony of Mr. Percival F. Brundage, Director of the Bureau of the Budget, who was extremely helpful to the subcommittee in developing the budget outlook for the current fiscal year and for fiscal years 1958 and 1959. This morning we are happy to have with us the Secretary of the Treasury.

93528—57——20

Mr. Secretary, we appreciate your taking the time from your very busy schedule to be with us today, and we are very happy to recognize you to deliver such statement as you care to make without interruption.

STATEMENT OF HON. GEORGE M. HUMPHREY, SECRETARY OF THE TREASURY

Secretary HUMPHREY. Mr. Chairman and gentlemen of the committee, I am delighted to be here to answer any questions that I can, and I have a very short statement, Mr. Chairman, which I will make if I may.

Chairman Mills and members of the Subcommittee on Fiscal Policy of the Joint Economic Committee, I appreciate this opportunity to appear before you on the subject of current budgetary and fiscal policy developments, a subject on which you have already heard from nunumerous witnesses.

Before responding to questions I want to repeat my conviction that although present tax rates are too high and the present heavy tax burden will, in the long-run, seriously hamper necessary economic growth, no general tax reduction should be considered at the present time. The most effective tax cut that can be made to promote healthy economic development is a reduction which will bring benefit to all taxpayers—when our fiscal situation permits. By this, I mean when we can see ahead a sufficient surplus of income over outgo to pay for such a tax reduction. We should and will keep working vigorously for the day in the not too distant future when we can see such a surplus. Such a surplus does not exist at the present time.

In this connection we must keep a close watch of our budget position and make certain that Government spending is conducted as efficiently as is humanly possible. There is nothing new in this goal. We must continue to follow the principles that have guided this administration for the past 4 years. We must make every effort to live within our means and to get a dollar's worth for every dollar that we spend.

In watching our budget we must constantly guard against ill-considered, or dangerous, or so-called meat-ax slashing of the budget.

As the President said in his April 18 letter to the Speaker of the House of Representatives, actual spending in the coming fiscal year cannot be cut by multi-billion-dollar amounts without danger to the national safety or interest or the modification of some of the existing programs heretofore authorized by the Congress. It is not the size of any particular budget which is our paramount concern. It is control of the upward march of total Government spending which is of greatest importance to all of us on a long-run basis.

The biggest budget problem, as I see it, is one of seeking out long-term savings. The problem of how much and for what we should spend in the fiscal year 1959—which will not end until 2 years from now—is already upon us. What we must continue to do vigilantly is to keep up not only the everlasting search for possible reductions but the drive to make them real. We must do this while being ever mindful of our position of leadership in the world and the obligations which we must necessarily bear in that regard to protect our national security.

We must balance the necessary costs of our national responsibilities with the equally necessary maintenance of a strong and vigorous economy.

The administration's fiscal record is a good one. The budget in effect when we took office in 1953 produced a $9.4 billion deficit, and the budget proposed by the prior administration for fiscal year 1954 called for a $9.9 billion deficit. Our administration, with the help of the Congress, cut spending, reducing the projected deficit for 1954 by two-thirds, or to a final minus figure of $3.1 billion.

But for the largest tax cut in history (a $7.4 billion cut in 1954) the budget would have been balanced in 1955. A balanced budget was delayed for 1 year because it was then apparent that the savings we then had in prospect would be sufficient before the end of the next year not only to cover the amount of the tax cut but to give us a balanced budget at the same time.

By fiscal 1956 we had eliminated deficits and had a balanced budget with a surplus of $1.6 billion. We will have a surplus in the fiscal year ending this month and the budget proposed for fiscal 1958 also is balanced. This means that we have in prospect a balanced budget for 3 consecutive years for the first time in more than 25 years.

Federal spending was reduced from the rate of $74.3 billion in the inherited budget of 1953 to $67.8 billion in 1954 and $64.6 billion in 1955. Spending moved up to $66.5 billion in 1956, to an estimated $68.9 billion in the January budget for the present fiscal year, and to a proposed $71.8 billion for 1958. Even with the recent increases the budget for the current fiscal year is $5.4 billion below the budget we inherited in 1953 and is 16 percent of our gross national product as compared with 21 percent taken by Federal spending in 1953.

If we are successful in properly controlling the size and spending of Government, we can look forward to a continuing period of high prosperity for our country. A major ingredient in this high prosperity is the confidence of the American people—confidence in themselves, in each other and, of fundamental importance, confidence in their Government.

The great hope for major reductions in Government spending lies in a better world situation. Some day the nations of the world must arrive at some better and insured form of understanding which will make it possible to reduce the large amounts of money and energy and resources now going into making things for killing. I confidently believe that such a better day will come.

The relationship between monetary and credit restraint and our present high prosperity is worthy of brief comment.

One thing that can destroy not only our present prosperity but even jeopardize our way of life is runaway inflation.

The record of this administration in helping control inflation has been good. The value of the dollar, which dropped from 100 to 52 cents between 1939 and January 1953, has changed only 2½ cents in the past 4½ years, compared with a total drop of almost 48 cents in the 13 years prior to this administration.

The credit policy of the Federal Reserve System is an important factor in sustaining the purchasing power of the dollar in this time of very high use of and demand for both labor and materials. The alternative of easy money would mean that there would be more dollars bidding for the available supply of labor and materials. This could only result in sharp increases in the cost of goods. The dollar would buy less.

Mounting increases in the cost of living would bring cruel hardship to millions of our citizens least able to protect themselves. There would be less saving which is the source of investment in plants and equipment which make the ever-increasing jobs that we must have for our growing population. Without increased savings—without the confidence that money saved would retain its value—we would have fewer of these new jobs. Over a period of time, growing unemployment would result.

It is essential that the inflationary pressures arising from the high prosperity that we have enjoyed for the past many months be controlled to the greatest possible extent. Restraints on credit involving some increases in the cost of money and the maintenance of taxes at the present levels, at least until such time as we have a substantial excess of income over expenditures, are important factors which will assist in restraining a substantial increase in the cost of living.

Thank you, Mr. Chairman, for the opportunity to present these observations to your committee.

Representative MILLS. Mr. Secretary, we apprepriate your statement.

If I may, I have a few questions I wanted to ask you with respect to your statement and certain other developments.

Mr. Secretary, I am sure that you have heard or seen in magazines and newspapers the repeated suggestions that the administration is planning to make some tax reduction proposals early next year; that this is in part responsible for the tax cut drive that is taking place at this time, at this end of Pennsylvania Avenue. I want to ask you, in all candor, whether there are such plans being developed in the administration at this time.

Secretary HUMPHREY. Mr. Chairman, there are no such plans that I know of. A tax cut this year, in view of our present circumstances, in my view is absolutely out of the question. It would be a great mistake to have it even considered.

Now, as to what may result next year, no one can say at this time. We have not our following year's budget prepared. We haven't plans made or programs set that anyone can count on at the present time. And I think it would be perfectly idle to make plans at this time for any tax cut until we know much more about what the facts are going to produce.

Representative MILLS. Actually, on the basis of the information we have, and assuming that we can hold our expenditures for fiscal year 1958 within the levels of the estimate of the President in his budget message January 1957, assuming that the Congress can make some reductions within that spending, limited as they may be with respect to fiscal 1958; looking strictly at the prospective surplus for that fiscal year, do you see any possibility, without regard to an economic downturn, that would permit us to reduce taxes with respect to any part of the fiscal year 1958?

Secretary HUMPHREY. It is very difficult, Mr. Mills, to say that, so far ahead. You are talking about 18 months ahead.

Representative MILLS. Yes. Between now and June 30, 1958.

Secretary HUMPHREY. Within a year.

Representative MILLS. Within a year. That is 12 months. A little over.

Secretary HUMPHREY. But it would be effective over——

Representative MILLS. Maybe I have not made myself quite clear. On the basis of what information we now have with respect to our prospective surplus for fiscal year 1958, ending, of course, June 30, 1958, do you see any possibility of applying any general tax reduction to any portion of that fiscal year?

Secretary HUMPHREY. Of the year 1958, that will start beginning the 1st of July?

Representative MILLS. Yes.

Secretary HUMPHREY. Unless there are very great changes in the figures, unless there are changes made that I have no reason to expect at the present time, I do not see how a tax cut can be made effective during that period. I don't see how we will have a sufficient surplus over our expenditures, surplus of income over expenditures, to justify an effective cut within that period of time.

Representative MILLS. I would like your comment, if I may, on the efforts that are being made by the administration and the Congress to reduce expenditures under the President's estimates for fiscal 1958 as presented in his January 1957 budget message. Are we actually effecting reductions in dollar spending in 1958 sufficiently, on the basis of what we have done so far, to change the picture materially?

Secretary HUMPHREY. Mr. Mills, I am trying to have a running record kept of just what these reductions are. It is a little difficult to keep up, as it moves around, because until the bills are finally enacted you do not know just where the reductions are. But up to date, the record of cutting of actual expenditures to occur within that period has been relatively very small. The cuts of importance have related largely to forward commitments and even rather substantially to cuts in appropriations for programs that the Congress has enacted where the bills must be paid; that if the present appropriation is insufficient, there will have to be subsequent appropriations made to cover the expenditures as they occur, because the programs have not been changed in any regard. Simply, the money has not been appropriated to cover what may result. And, of course, you cannot pay a tax cut out of reductions of that kind.

Representative MILLS. Mr. Secretary, the Director of the Bureau of the Budget yesterday, in his conclusion, advised the subcommittee that he thought the earliest possible time for tax reduction consistent with responsible fiscal policy might be sometime during the fiscal year 1959, which will begin, of course, on July 1, 1958, and end on June 30, 1959, as you know. In other words, it might be possible for us to reach the time for tax reduction within responsible fiscal policy, say, by January 1, 1959. That would be a part of the fiscal year 1959. He was basing his statement, I guess, on his close study and the best available information before him of the effect of the reductions that we are trying to make with respect to the budget for fiscal year 1958. He might be right in his conclusion?

Secretary HUMPHREY. He might be right, and I would think that the weight of the evidence was in favor of his conclusion at the present time.

Now, of course, looking ahead a whole year, or, as you now are looking 18 months, a great many things can happen. And I would not think that it would be possible for anybody to make a definite statement about it, but the weight of the evidence is in that direction at this time.

Representative MILLS. Virtually all of the witnesses that we heard before our subcommittee last week agreed that neither economic conditions nor budget prospects would warrant tax reduction legislation at this time.

Secretary HUMPHREY. There certainly is nothing, Mr. Chairman, to warrant it at this time.

Representative MILLS. Especially is that true if fiscal policy is to be consistent with preventing further inflation, as you suggested it should.

Some of these experts felt that we should prepare a program of tax reduction now, however, so that we could be ready to enact such legislation promptly if business activity turned down or if we do in fact accomplish reductions in dollar spending in fiscal 1958. What is your view on the timing of (1) the preparation of a tax-reduction program, and (2), the enactment of tax reductions?

For example, under the present kind of economic conditions, should we enact legislation reducing taxes before we succeed in actually getting spending down in keeping with the desire that all of us have and the degree of the tax reduction that we would like to enact?

Secretary HUMPHREY. Mr. Chairman, I am opposed to both of those suggestions. On the other hand, I want to just elaborate a bit on the last comment you have just made.

Now I will go back and start over. Your first suggestion, as I recall it, is: Should we prepare a program for tax reduction now for some future use?

Representative MILLS. That is right.

Secretary HUMPHREY. I think it would be perfectly idle to do that. Our total tax collections are in the area of seventy-odd-billions of dollars. A 10-percent reduction would take $7 billion. A 5-percent reduction would take $3½ billion.

Until you have some idea of in what area the reductions are going to take place, whether it is in the area of excise taxes, or whether it is in the area of income taxes, or how your customs and miscellaneous income are coming along, until you can get a pretty good idea of what your income is going to be, as well as your expenses, it is just idle to try to estimate how you would make a tax reduction.

For instance, if you were to have a surplus available, apparently becoming available, for a 5-percent reduction, you might view it in one way. If it was for a 10-percent reduction, you might view it in quite a different way. And I think it is just idle to speculate way ahead.

Now, your second suggestion is that some law be enacted, as it was at one time. I do not know just where it came from, but there was a proposal here some time ago of enacting a law specifying certain fixed tax reductions under certain fixed conditions. Again, I am opposed to that. I think that would be an idle thing to do. I recognize that it is nice to have people have an object to shoot at, to try to accomplish a result, and it might stimulate some further activity toward saving of money, but again, until you know where the savings are going to be made, what taxpayers are going to be affected by the savings, it is just impossible, I think, and idle, to try to lay out a program way ahead of time with such great variations in the amount of money that you might have available to distribute.

Now, I just want to say one word about your very last comment. As I understood you, it was this; maybe this is not exact, but the purport of it was: Would it be possible to consider any tax reduction until we actually had the money in hand to pay the tax amount that was to be reduced?

I don't think that is correct. I don't think we ought to wait until we actually have the money in hand. I think that the proper way to consider a tax reduction, and the proper timing of considering a tax reduction, is to forecast ahead, and when you reach a point of reasonable certainty, as to where you are going to be, when you have reasonable certainty as to what your income is going to be from various sources, as to what your expenditures are going to be from various sources, and as to what your surplus is going to amount to, that you can count on, then I don't think you have to wait until you have the money in the box. I think you then should begin to plan on how you make your tax reduction for that amount of money that you can reasonably count on receiving, and that the tax reduction should be made effective along about the same time that the expenditures are being cut and the taxes are going down, so that they rather parallel each other over a time in the future and take place together.

Representative MILLS. In other words, immediately translate the reduction in spending as it occurs, into tax savings for the American people?

Secretary HUMPHREY. That is right. And you do not need to wait until you have $5 billion cash on hand before you begin to do it. But if you can see $5 billion with reasonable certainty, that you are going to have as surplus over a period of 12 months, then it is perfectly proper to plan a tax reduction to become effective concurrently with the effectiveness of the surplus.

Representative MILLS. Mr. Secretary, can you give us some information as to how we can properly evaluate the development of that type of a situation? Now, how can we tell a few months ahead of time that conditions will call for tax reduction? What shall we look to? What are the factors that should guide us in determining that, reaching the conclusion that the time is right?

Secretary HUMPHREY. That is an extremely difficult thing, Mr. Chairman. Making these budgets is an extremely difficult thing. I have said half facetiously a number of times that about all we can do with the budget is to hope that we make so many mistakes that they will offset each other, and we will come out about where we estimate. And that is half facetious, but it is half true.

With these figures, that are as big as they are, that we are dealing with, just think of it: We spend a billion dollars every 4 days. If our mail receipts are 4 days late, we can be out a billion dollars at the end of a year.

Now, when you can have fluctuations of that size, it is small. A billion dollars in relation to $70 billion is small in total expenditure. But a billion dollars in relation to a surplus of a billion dollars—the net figure is awfully big. And you could have it all wiped out in a very easy fashion by just some unexpected thing.

Now, I don't think you can estimate it too far ahead. I think it is a matter of comparatively few months, rather than a long period of months. I think you can estimate it on the basis of appropriations and plans and on the basis of actual trends of expenditures. If the expenditures are a downtrend, and if your trend of income is an uptrend, you have to estimate not only the position of the economy, whether it is going to be good or bad, but you also have to estimate what the Government is going to do in its spending as you are looking ahead down this road that you are talking about. And I think it cannot be forecast too far ahead, and I think that you have to be pretty sure of what your conditions are before you dare to go ahead and act.

Representative MILLS. Mr. Secretary, actually, are we not misleading ourselves when we proceed on the assumption that we can create the day for tax reduction by continuing existing programs, without cutting them back in any way, and merely on the basis of some adjustments within the appropriation bills with respect to these programs? What I am getting at is this: Is not the practical way to create the day for tax reduction of necessity the one that involves the Congress and the administration going into these programs, and attempting to cut back existing programs that of necessity, in a rising economy, are going to cost us more each year if they are not cut back?

Secretary HUMPHREY. I cannot absolutely prove it in figures, Mr. Chairman, but I am just as certain as I can be that you are right. I am as certain as I can be that the programs that we have, with the open ends in so many programs that we have, will almost inevetiably lead to expenditures that will eat up our income as we go along, and that we will not see the day, unless there are some revisions of programs—we will not see the day for a long time that will permit tax reduction.

Representative MILLS. So the job, then, before both the executive departments and the Congress is to try to reach some sound conclusions with respect to reduction in service by Government at the core of these programs?

Secretary HUMPHREY. I think that is correct. And I think that a number of programs have to be reexamined with that thought in mind.

Representative MILLS. Of course, both of us are speaking now without regard to a business downturn that might change the entire picture.

Secretary HUMPHREY. That is a horse of another color entirely.

Representative MILLS. That is right. We were not taking that into consideration.

Secretary HUMPHREY. That is correct.

Representative MILLS. Mr Curtis?

Representative CURTIS. Mr. Secretary, one specific question: I notice you anticipate the budget surplus as $1.6 billion. How is that going to be applied on the debt reduction? What proportion of the debt will you not refinance? How will you apply that?

Secretary HUMPHREY. Mr. Curtis, there really is not any way that you can say how you apply a certain number of dollars. Where 1 dollar goes is practically impossible to trace.

Now, what happens is just this: That as we save some money, as we accumulate some surplus, the first thing that happens is that our cash does not get down quite so low. And, of course, the surplus gradually accumulates in the cashbox. Then, as we go ahead and issue various kinds of securities and refundings or temporary cash for various purposes, because we have had a little more cash on hand we have a little less securities that we have to put out. And just where any one dollar will fall in the future, it is impossible to tell.

Representative CURTIS. You do not pursue a particular policy then, or you would not, in these surpluses, if they were used to reduce the Federal debt? You would not say, as a matter of policy, "We would like to apply it in this area of the debt," say, long-range securities as opposed to short, or anything of that nature?

Secretary HUMPHREY. Well, where it falls all depends on the kind of securities you have to issue as time goes on to meet market demands. And you will issue more of one kind or another, depending upon the market requirements. Now, you will either have, as you accumulate a surplus, an addition in cash, or you have less debt outstanding.

Representative CURTIS. Perhaps I can illustrate what I mean. You could, as a matter of policy decide it would be well not to reduce any of the outstanding amounts in E-bonds, for example, as opposed to another type of Federal security, on the theory that that tends to be a general public savings opposed to bank-held Government securities.

Secretary HUMPHREY. That is, I think, a net result, although you arrive at it the other way around.

Representative CURTIS. I see.

Secretary HUMPHREY. The way you arrive at it is: What securities best meet market conditions that you can sell as you go along. And those are the securities that you sell. And if there is an excess of cash, you do not have to sell some of the others.

Representative CURTIS. Rather than from a standpoint of a policy that might be affecting an economic situation.

Secretary HUMPHREY. Well, it affects the economic situation just as much one way as the other, of course. Because if you retire—let us just take a hypothetical case. Suppose you had a billion dollars of increase in cash because of a surplus that was more than you required, and you could use that billion dollars in reduction of debt, instead of keeping it in cash on hand. And suppose you applied that and arbitrarily bought in or canceled a particular issue of bonds. Let us assume just for the sake of argument that you then have another issue that is maturing, and it is an issue that makes a good deal of difference in what the market demand may be. You have to tailor your sale of the new issue to fit the market demand at the time you go to sell it, and you might just wash out what you had done before.

Representative CURTIS. And yet, though, in your presentation before the Ways and Means Committee on the question of raising the interest rates on our E-bonds, for example, we discussed the balance of how much holdings there were of the public in E-bonds in relation to other types of Government securities. And we discussed the idea of balance. So it seems to me, as a matter of policy, some thinking should be done along the line. If we had $5 billion, to make it a more sizable sum, of surplus, the tendency would be to want to apply it in a certain area.

Secretary HUMPHREY. And the way it would be applied would be the way you issue your new securities.

Representative CURTIS. One other item on that particular thing. The fact that there is a surplus in the highway fund, of course, permits you to just put Government securities in there without having to test the market for those. That, to that degree, has eased the problem of sale of Government securities, has it not?

Secretary HUMPHREY. Well, to a slight extent. You have not got quite the same amount to take from the public in that form. It is a very minor thing. And, of course, it is going to be used soon, anyway.

Representative CURTIS. It is going to be used soon. But, of course, when we apply that across the line to all our other reserve funds, particularly social security, it actually is a sizable amount that the Federal Treasury does not have to market.

Secretary HUMPHREY. They do not have to go to the public for that additional money.

Representative CURTIS. Now, one item on the expenditure side: Yesterday we discussed and put in the record a table on page 12 of a publication, Tax Reduction and Tax Reform—When and How, prepared by the research and policy committee of the Committee for Economic Development. And this is simply to refer to the figures. It shows for the years 1948 actual and 1958 proposed by expenditures, and then shows the increase and decrease. One thing I was concerned about was the fact that these figures did not include the amount of money that we spend each year in counterpart funds.

Now, the explanation from Mr. Brundage was that the expenditures of counterpart funds are not included in the overall expenditures as computed by the Bureau of the Budget and I presume by Treasury. But that was the question I wanted to ask.

Secretary HUMPHREY. I don't quite know what you mean by expenditures for counterpart.

Representative CURTIS. Expenditures of counterpart funds. For example, many of our expenditures on our foreign-aid program do not come to the Treasury—for that money. Those moneys exist on account in these various countries where we have generated these counterpart funds.

Secretary HUMPHREY. Well, there is some.

Representative CURTIS. Oh, it is in the billions.

Secretary HUMPHREY. Oh, no.

Representative CURTIS. Oh, yes, sir.

Secretary HUMPHREY. A lot of people say that, but I have never been able to find it.

Representative CURTIS. Well, that is the whole point. For instance, we just passed a bill, I might say, Mr. Secretary, in the House, on agricultural disposal, and these are in billions of dollars of agricultural commodities, in which we gave permission to the Secreary of Agriculture up to I think the amount was $2 billion to make arrangements where those surpluses could be exchanged for counterpart funds. And in turn those counterpart funds could be spent for almost the identical items for which we drew on the regular Treasury for funds for foreign aid, and I am talking in terms of several billion.

Secretary HUMPHREY. It is one thing to give an authority. It is another thing to get the billions.

Representative CURTIS. This does not go through the Appropriations Committee.

Secretary HUMPHREY. It does not come anywhere, in reality. That is what I am trying to tell you. It is an authority, but nothing happens under it in large amounts.

Let me just tell you where we are. Let me give you some actual figures, and then you will see right where we are.

We had on hand on the 31st day of March last year $1,256 million of counterpart funds, total, everything. We had anticipated receipts of $1,356 million of counterpart funds to come over the rest of the year, or a total of $2,612 million. Eighty percent of that is by agreement to be lent back to the countries from which it comes. So you are talking about 20 percent of it, which is about $500 million over the whole year. It is about $250 million that is on hand now, and it would be, if it all came in, about $500 million if they made good all around.

So you are talking about relatively very small items.

Representative CURTIS. Well, Mr. Secretary, inasmuch as we have now set up this program on agricultural disposal, where we have given the authority——

Secretary HUMPHREY. They had it all last year.

Representative CURTIS. Yes; they did, but not as to these additional sums.

Secretary HUMPHREY. There was no limit on what they could do last year. They had plenty of room to get counterpart funds in last year. Now you have renewed and extended the authority.

Representative CURTIS. And increased the amount.

Secretary HUMPHREY. But it is one thing to increase the authority and another thing to accomplish the result.

Representative CURTIS. What I am really getting to is that, in this showing of expenditures for 1948 for international affairs and financing, we have $5.6 billion and, in 1958, proposed, reduced to $3.1 billion; the one item in the budget, incidentally, which had decreased. But at the same time we have in 1948 for agriculture and agricultural resources $0.6 billion expenditures in 1948, and in 1958 the amount has been raised to $4.9 billion, which, to a large degree, and this is my interpretation, has to be taken together with your international affairs and finance, in order to get that full picture. Because these funds do not go through the normal channels if they go into counterpart funds. And the essential question I am coming to is: How much control does Treasury have over that operation? Is the way it works outside of yonr purview?

Secretary HUMPHREY. The deals that are made with respect to it are outside the program. The actual handling of the funds comes through the Treasury.

Representative CURTIS. In other words, these counterpart funds would be deposited in banks abroad.

Secretary HUMPHREY. They are subject to our order. They are subject to Treasury order. But the amounts involved, Mr. Curtis, you will find, I hope, will be right, in that they will be larger, but there has been no experience of that kind so far. Up to date, you are talking about relatively very small items.

Representative CURTIS. Now, one item in regard to inflation and its effect on these Federal expenditures. I note the increase, of course, as you gave us, on the expenditures, beginning really in 1956, from $64.6 billion to $66.5 billion, and then on up each year. Now, inflation has had some bearing on that, has it not?

Secretary HUMPHREY. Yes; it has.

Representative CURTIS. Would you say that is a major item?

Secretary HUMPHREY. No; I do not think so. The actual cost-of-living indexes are still relatively stable. There are certain items, particularly in defense, where costs have increased, and under the escalation clauses of their contracts they have to bear the additional cost. But I think the principal addition in cost has come through the adoption of new things, the buying of new things, and much more expensive things as we go along. The expense of modernization in military equipment is just almost unbelievable.

Representative CURTIS. In your projections, do you anticipate further inflationary effects?

Secretary HUMPHREY. We hope that it will not be much. We hope that we can hold the cost of living within reasonable bounds. That is our objective. That is what we are working days, nights, and sundays to accomplish, and we hope we will be successful.

Representative CURTIS. Now, in your analysis of these inflationary forces, is not one of the major items a shortage of investment capital?

Secretary HUMPHREY. Yes, sir. All over the world.

Representative CURTIS. Now, getting to our tax structure, then, as you point out, in the long run these higher tax rates will seriously hamper necessary economic growth. Is it not entirely possible that by analyzing some of our particular taxes we can pick out those that are particularly hampering economic growth and possibly do something in that area? I do not like to call it necessarily tax reduction, but certainly tax revision.

Secretary HUMPHREY. Well, there is something of that sort possible. Your committee has spent a great deal of time this year and has, I think, made a very constructive consideration of a lot of items. I think it has been an excellent performance and was done very very well. That is not equivalent to a tax reduction. It is an adjustment of taxes, a closing of loopholes, or a removal of special hardships, and things of that kind. And that always should be kept in mind.

Representative CURTIS. It has been relatively small and detailed items rather than any broader aspect that might be hampering economic growth?

Secretary HUMPHREY. That is correct. But, actually, until the time comes when you can see your way clear to substantial reduction in taxes, there is not much you can do about these adjustments that you speak of. They should be certainly kept in mind, and should be carefully studied and thought about when the time comes that you have money to release. But, until the time comes when you have got money to release, you are not getting very far by studying them.

Representative CURTIS. But your main interest is solely based on need for revenue, is it not?

Secretary HUMPHREY. Yes, but there is nothing you are going to do, Mr. Curtis, by a change in just some provision of the tax law that is going to greatly increase the revenues to offset a tax reduction.

Representative CURTIS. Well, I simply want to make this suggestion: that in looking at our revenue collections over the same periods that you gave, 1953, $67.8 billion; 1954, $71.6 billion—and then here is where we had what I call a tax-revision bill rather than really a reduction bill.

Secretary HUMPHREY. It cost us a billion and a half or so for the tax revision in 1954. That is not chicken feed, you know.

Representative CURTIS. Exactly. And collections went down to $67.8 billion. But I want to call attention to the immediate rise thereafter to $77.1 billion the next year, which would indicate that maybe it really was revision, and hitting at these things that were disturbing economic growth, because we then go on to $81.7 billion and then to $86.1 billion. And that is with the tax structure change, with this so-called tax reduction. And all I am trying to point out is that, taking your basic statement in the long run, necessarily seriously hampering economic growth, if we could dig into this thing and find out where we are hampering investment capital and possibly revise it that way, we would not lose the revenue. There may be an immediate loss, but it would be picked up, if the past is any indication, pretty quickly, from a revenue standpoint.

Secretary HUMPHREY. Well, of course, there are a lot of other things that entered into this change you speak of, a lot of other conditions. And if you will check your employment figures and your gross national product figures, and all of those things, you will see.

Representative CURTIS. May I point out: Of course, your gross national product is the very thing we are talking about. Because that is economic growth.

Secretary HUMPHREY. Well, you have got a country that is growing at the rate of perhaps a million new jobholders a year. And as you go on and get those millions of new jobholders every year, if you are able to provide the capital to provide them with the tools and the requirements that are necessary for them to earn the high incomes that they do earn, you will increase your tax take. And if you will study our income specifically, you will see that almost our entire increase in income has come out of individual taxes. The corporate taxes have been relatively stable in the last short period, here, and the individual income, because of the increased numbers of people at work, the place where the money is coming from, that increases our tax take.

Now, as we go on, year after year, and we will, increasing the number of people available to work, if we can so handle our affairs as to keep them in high-earning jobs, we will gradually increase our total revenues, our total tax revenues, either at the same rate or at lower rates. And my point that I want to make is, particularly, that I think that our tax structure is so high that it is impeding our incentives, our individual incentives, and that it is impeding our investments. The necessity for additional investment capital, the growth, enough growth; we have growth but it has to be more all the time, to buy the tools to make the jobs to keep the increasing number of people employed. As time goes on, you are entirely right; lower rates over a period of time will bring more income.

Representative CURTIS. Thank you, Mr. Secretary.

I have two other specific questions. These two relate, it seems to me, to this question of capital investment. And in our tax structure, we have many provisions which actually channel capital investment in certain areas. One is this rapid amortization. I do not believe I am mistaken, I believe you are on record in recommending that we eliminate that. Is that not true?

Secretary HUMPHREY. I was the first man in this Government, in the executive department or in the Congress, to demand that that be reduced, and I have followed it through until it is reduced, I am very glad to say.

Representative CURTIS. I wish it were eliminated, Mr. Secretary.

Secretary HUMPHREY. Well, there is a bill pending to very substantially reduce it. But I will say this: that we have already accomplished, by executive action, approximately all, and I am not sure that it is not all, that the bill would accomplish.

Representative CURTIS. Now, one other thing: It is directing attention to the same thing, of channeling capital investment. It is a question of depletion allowance for extractive industries. I wrote you a letter on that, I know you will recall, where I suggested that we ought to get into this area and study it, becase this is a method of possibly giving preferential treatment whereby investment money is channeled into this particular field.

Now, it seems to me that that also is an area that we can well go into if the cause or one of the underlying causes of inflation is this shortage of investment capital.

Secretary HUMPHREY. Well, I think that is peculiarly in the province of the Ways and Means Committee. I think that is strictly a Ways and Means Committee job. I think it is a very proper thing for them to consider. And as I testified to the Ways and Means Committee, I think that any of these—I do not like to call them arbitrary, but any of these provisions by law for reductions in income, deductions, provided by law, should very properly be reviewed from time to time to see whether or not they are carrying out the national purpose.

Now, generally speaking, as I testified to the Ways and Means Committee, I believe in a general way that the depletion allowance, as provided by law, has been carrying out the national purpose. I think it has been a long time since it has been carefully reviewed. I hold no brief for any particular amount. The general principle, I think, is correct. The exact amount, I think, can be reviewed and, from time to time, should.

Representative CURTIS. Thank you, Mr. Scretary.

Representative MILLS. Mr. Secretary, we have with us this morning the chairman of the Joint Economic Committee.

Mr. Patman would like to ask a few questions of the Secretary.

Representative PATMAN. Mr. Secretary, I always enjoy your testimony. You make very clever replies, which I know are very sincerely and honestly made. I always profit from what you say, though I do not always agree with it. But I do find myself in agreement with much of what you said in your statement, particularly about tax reduction. I agree that we should not consider tax reduction at this time, and I agree, too, that we should not consider it until we have a substantial amount in sight in the Treasury. And I, too, believe that any tax reduction bill should make sure that we left enough to pay a substantial amount on the national debt. Do you not think we ought to make payments regularly on the national debt as we make tax reductions, Mr. Secretary?

Secretary HUMPHREY. That is certainly the ideal thing to do, Mr. Patman. I do not, however, think that it is wise to make any long-term arbitrary determinations. I think that sometimes conditions would be such that it would be desirable to use a very substantial part of your surplus that you might have in reduction of that, and at other times it might be desirable to use less of it.

Representative PATMAN. Yes, sir. I understand that that is true.

Since the Congress is supposed to adjourn, if we do not run into trouble, within a reasonable time, I assume the Treasury has decided whether or not it will ask for an increase, a temporary or permanent increase, in the national debt limit.

Secretary HUMPHREY. I did not know that the Congress ever had trouble, Mr. Patman. That is news.

Representative PATMAN. Every day.

Secretary HUMPHREY. I wish I could tell you.

We are hoping that we will not have to ask for it. We are on very narrow ground. We are waiting until we get a little better view of what the Congress does with respect to the budgets. If, instead of receiving some reductions, we should get some substantial increases—and there have been some increases; some of the budgets that have been passed have been increases instead of reductions. And in many cases, as I said a moment ago, the reductions are not real reductions; that is, they are not reductions that do the Treasury any good. They are not cash money reductions effective between now and the first of the year, or the close of the fiscal year. Until we get a little better view of that and see just what those proposals are going to be, we are still hoping that we will not have to ask for a change. But it is a very tight fit.

Representative PATMAN. In other words, if the budget is not increased, you would not ask for a change?

Secretary HUMPHREY. I think that is about it.

Representative PATMAN. Now, there is a lot of talk about the Federal Reserve Board increasing the rediscount rate. There is some talk that the Treasury is encouraging it. The Treasury is not pressuring the Federal Reserve, I know, to increase that rate.

Secretary HUMPHREY. No, we are not.

Representative PATMAN. I just wonder if the Treasury is encouraging it.

Secretary HUMPHREY. I did not even know there was a lot of talk about it.

Representative PATMAN. I do not know why I hear these things, when you do not.

Secretary HUMPHREY. Well, we live in a big building with thick walls, and we do not hear much.

Representative PATMAN. You are not encouraging the increase in the discount rate among the Federal Reserve banks?

Secretary HUMPHREY. Not at this point.

Representative PATMAN. Do you believe that at some point the Federal Reserve Open Market Committee should support the price of Government bonds? The reason I ask you that: On yesterday, the 3 percent bonds went below 90, I believe, for the first time, I have not been watching it closely, but it is the first time I noticed that the 3 percent bonds went below 90. Do you not think, Mr. Secretary, at some point the Federal Reserve should prevent such a disorderly market and come to their support on those pricings?

Secretary HUMPHREY. You are saying two things, I think. I do think the Federal Reserve Board can very properly help to preserve an orderly market. I do not think that the Federal Reserve Board should adopt arbitrary supports.

Representative PATMAN. Do you not think it is on the brink of disorderly market—3 percent Government bonds going below 90?

Secretary HUMPHREY. The price does not necessarily mean that it is disorderly.

Representative PATMAN. I see your point.

Secretary HUMPHREY. As long as there are not wide and precipitate fluctuations and you do not find voids in the market and all that sort of thing.

Representative PATMAN. Now, under certain circumstances these bonds that are down, I see, to 87 today, can be used at their maturity value for the payment of certain taxes; is that right?

Secretary HUMPHREY. I think that is right; estate taxes; I believe.

Representative PATMAN. Can they be used for any other purpose?

Secretary HUMPHREY. I really cannot tell you.

Representative PATMAN. Has any consideration been given to allowing people, you know, who bought those bonds under circumstances during the war when at least they thought they were led to believe that they would always be able to get their money, and now they are in distress and have to have their money—there is no consideration being given to any plan in that connection?

Secretary HUMPHREY. You mean that we would buy bonds under par?

Representative PATMAN. Yes.

Secretary HUMPHREY. No, sir.

Representative PATMAN. The estate tax is the only place where they can get maturity value?

Secretary HUMPHREY. I believe that is right. That is part of the original condition of the bond.

Representative PATMAN. Yes, sir. Do you not think, Mr. Secretary, that some consideration could properly be given to a fixed rate of Government securities and let all the other rates be flexible?

Secretary HUMPHREY. To do what?

Representative PATMAN. A fixed rate for Government securities, but permitting all other rates to be flexible.

Secretary HUMPHREY. You mean that the Government would always put its money out at a certain rate?

Representative PATMAN. At a fixed rate, yes, with the support of the Government, the Federal Reserve System.

Secretary HUMPHREY. I do not think you could possibly do it.

Representative PATMAN. You do not think it would work out that way?

Secretary HUMPHREY. Not at all.

Representative PATMAN. You stated a while ago that we are spending a billion dollars every 4 days. That is $250 million a day. To the best of my recollection, we did not spend any more than that during the most expensive period of World War II.

Secretary HUMPHREY. Yes, we spent almost $30 billion more in fiscal 1945. Even in the first year we were here, we spent, on expenditures that we inherited and had to pay the bills for, about $5 billion more than we are paying this year.

Representative PATMAN. I was thinking of $250 million a day. I do not know of any period during World War II when we spent more than $250 million a day.

Secretary HUMPHREY. You will just have to divide it. The fact is that it involved the expenditure of $5 billion more in fiscal year 1953 to pay the bills that we are now spending.

Representative MILLS. We appreciate very much your appearance this morning and the information you have given the committee. You are always helpful.

May I say this, because I may not have the opportunity to do so before you leave the Government: that all of us in the Congress, I am sure, will greatly regret the fact that you are leaving, and we hope that your absence from Government will only be temporary, and we hope if this administration is to continue they will find some way to bring you back.

Secretary HUMPHREY. Mr. Mills, I appreciate very greatly what you say, and I just want to say this to all of you gentlemen here present. Mr. Patman, you and I have not seen eye to eye in some directions, but I have thoroughly enjoyed my opportunity to meet with you gentlemen, and I feel that every one of you has been constructive. My relations with you particularly, Mr. Mills, have been very constructive for the benefit of this country, and I think that is true for all of you. And I regret that I have to leave, but that is the situation.

Representative MILLS. Thank you, Mr. Secretary.

Representative PATMAN. Best wishes.

Representative MILLS. The subcommittee will stand adjourned until 2 o'clock, when it will continue its hearing in this room.

(Whereupon, at 11:10 a. m., a recess was taken until 2 p. m., this same day.)

AFTERNOON SESSION

Representative MILLS. The subcommittee will come to order, please.

The Subcommittee on Fiscal Policy this afternoon concludes its hearings, on fiscal policy implications of the economic outlook and budget developments, with the appearance of Mr. William McChesney Martin, Chairman of the Board of Governors of the Federal Reserve System.

The purpose of these hearings has been to subject the economic and Federal budget situation and prospects to careful scrutiny in order to determine the proper course of Federal fiscal policy in the coming months. We have approached this inquiry in the light of the Employment Act objectives of economic growth and stability. We are all aware of the great importance of Federal fiscal policy in providing the setting within which our enterprise economy can proceed on a steady and noninflationary course of economic growth.

Last week we had the benefit of testimony by 33 non-Government experts with respect to the current economic situation and prospects for the remainder of 1957; the effect of current congressional and administration efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957–58; the types of fiscal action consistent with economic stability and growth

93528—57——21

if spending reductions are achieved; and the timing of fiscal action in relation to budgetary and economic developments.

Yesterday afternoon we were privileged to have the testimony of Mr. Percival F. Brundage, Director of the Bureau of the Budget, who was extremely helpful to the subcommittee in developing the budget outlook for the current fiscal year and for fiscal years 1958 and 1959.

This morning we heard from the Secretary of the Treasury and he was very helpful also. Now we are happy to have with us Mr. Martin, whom we are certain will also provide us valuable assistance as he always does. Mr. Martin, we appreciate your taking the time from a very busy schedule to be with us this afternoon, and you are recognized to make such statement as you care to, without interruption.

STATEMENTS OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, AND WINFIELD W. RIEFLER, ASSISTANT TO THE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MARTIN. Thank you, Mr. Chairman.

This committee and the Board of Governors share a common concern: that the operations of both monetary and fiscal policy be directed—in the words of a report issued by your committee in January 1956—to "maintaining a steady and sustainable rate of economic progress."

On behalf of the Board of Governors, I should like to outline some thoughts which we believe would contribute to the achievement of this common objective.

Events have moved swiftly since passage of the Employment Act of 1946. Congressional debate and expert opinion preceding passage of that act were in close agreement in pointing to unemployment of men and machines as the primary threat to the national economy. The history of the period since the war, both in this country and abroad, however, has demonstrated that the primary danger was not one of idle men but was one of too much money.

I might state that Mr. Riefler, my associate and I, have just returned from Europe and we find this situation to be quite general abroad as well as in this country.

Almost everywhere in the world, pressure on resources has been intense. The necessity of preventing competing claims for scarce resources from resulting in general price increases has been a major problem. Defense needs have been a major claimant. Other demands on resources have been bolstered by pressing individual and community needs, on the one hand, and by large financial assets, strong liquidity positions, and rapidly rising current incomes on the other. Even so, the opportunities for vigorous growth and accelerated technological progress resulting in sharply rising standards of living and increased security, especially for those in the lower and middle income groups, have been very great. Even greater opportunities lie ahead, ready to be realized if the threat of international conflict can be reduced and the insidious inroads of inflation curbed.

Inflation is never harmless, even in its mild or "creeping" form. Neither is it inevitable. Given appropriate monetary and fiscal policies, reasonable restraint by consumers and businesses in their spending decisions, and continuing keen competition, price stability with a rising standard of living can reasonably be expected. On the other hand, acceptance of the gradually rising price theory carries with it a widening expectation of further rise. This leads in turn to financial overcommitments, speculation, misdirected expansion of capacity, slackened efficiency, erosion of existing savings and discouragement of new savings, and an ultimate reaction of a serious nature.

For about 2 years we have been experiencing an intensified demand for funds, and, although the supply of savings and the volume of bank credit have both increased, expanding demands have outpaced their availability to potential users except at rising interest rates. Consequently, the price of money has risen. If bank credit had been allowed to increase more rapidly under these circumstances, prices of goods and services, including those purchased by Federal, State, and local governments, would have risen further under the stimulus of inflationary credit pressures. How much further no one can say, but the strength of inflationary forces has been and is still formidable.

An increase in the volume of savings is the most effective way to deal with a situation whose inflationary potential would only be aggravated by an excessive use of credit. As these savings are made available to meet demands for more housing, schools, and other public improvements, as well as expansion of new business plant and equipment, they provide the resources for stable economic growth. To the extent that fiscal policy results in a budgetary surplus and the Federal debt is reduced, the supply of savings is increased and the need for monetary restraint lessened. This is because maintenance of a surplus permits funds to be channeled through Government debt retirement into the capital markets where they would be available to meet private demands and the demands of State and local governments for funds to carry through their projects for needed community facilities.

A reduction in taxes would bring welcome relief to millions of taxpayers. Such action, however, without a corresponding curtailment in Federal expenditures, would reduce or eliminate the budget surplus, and tend to stimulate increased total spending in the economy. At the same time the supply of funds made available to the capital markets through Federal debt retirement would be reduced.

As a number of witnesses who appeared before this committee have pointed out, the general economic situation is still one of very active demands, intensive utilization of resources, and continuing pressure toward higher prices for goods and services. They have also noted the declines in residential building and some consumer durable goods, the slight falling off in total industrial production and the drop in prices of some sensitive commodities. However, the general economy is still being stretched by record levels of plant and equipment outlays, rising demands for State and local government projects, further increases in consumer buying, and continued need for large-scale spending. On balance, the situation does not seem to us to reflect a basic weakening that would call for relaxation in efforts to curb inflationary pressures.

Your committee has indicated an interest in the consideration given to current and prospective economic trends in the formation of Federal Reserve policy. Since Federal Reserve System operations reflect to some degree all phases of the Nation's economic life and have a pervasive influence on it, they must be adjusted on a day-to-day basis to the ever-changing situation. Accordingly, the system has need for as much current and background economic information as it can assemble.

Efforts are directed toward bringing together, and combined as background for our decisionmaking the best available statistical information and the best informed impressions and judgments that can be obtained from businessmen, bankers, agricultural experts, labor leaders, and from others both in and out of Government. We also depend on information collected and compiled by other agencies of the Federal Government. For this reason it is important to the proper formulation of monetary policy that the statistical facilities of the Federal Government be well manned.

In our appraisal of economic developments, maximum use is made of the decentralized structure of the Federal Reserve System. Through the 12 Federal Reserve banks and their 24 branches, in business and financial centers all over the United States, and especially because of the caliber and experience of men who serve as the directors and officers of these institutions, the Federal Reserve is in close touch with current and prospective developments throughout the country.

In accordance with provisions of the Federal Reserve Act the Board meets frequently with presidents of the Federal Reserve banks, who serve as members and alternates, on the Federal Open Market Committee. The act also provides for quarterly meetings with the Federal Advisory Council, composed of representatives of the member banks in each district. These occasions make it possible to study continuously underlying developments in all parts of the country and all sectors of the economy.

Much of the statistical data and other information we collect for our own policy decisions is also made available to the public in general. We believe this is as important as its internal use, because it helps to provide a basis for better public understanding and more accurate appraisal of credit and monetary problems and of policy actions designed to deal with them.

Representative MILLS. Mr. Martin, we appreciate your helpful statement.

Mr. Curtis, do you desire to inquire of Mr. Martin?

Representative CURTIS. Yes. Mr. Martin, I would like to ask whether in your projections you feel that this inflationary move or the rise in price index will continue.

Mr. MARTIN. I don't know the answer to that, Mr. Curtis. We think that it is a situation that requires our constant watching and at the present time, as I indicate in my statement, we don't see any need at the moment for relaxing.

Representative CURTIS. I haven't seen the figures in the price index since April, but it continued to rise then. Maybe I can put in in another way. What do you feel is the primary or the major factors in this price increase? Would you say that shortage of capital investment is an important element?

Mr. MARTIN. I would say that the primary problem is the shortage of savings and that the only way we can finance the the capital development boom that is going on, the capital goods boom, plant and equipment expansion, in a sound way is out of savings. If we use bank credit, which should be largely short-term self-liquidating paper to cover this type of investment, we are asking for trouble in the future.

Representative CURTIS. In other words, that is another way of saying there is a shortage of savings, or at least it is a shortage of capital investment, which, of course, has to come ultimately from savings, because it can come no other way?

Mr. MARTIN. That is right.

Representative CURTIS. The trend would seem to be continuing in that area. Do you see in the immediate future an easing up of this shortage of capital investment or savings, as you put it?

Mr. MARTIN. I don't want to make a projection. I don't want to make a forecast. However, I will stand on our statement that we don't see anything at the moment that will lead us to believe that there is a basic weakening development that would call for relaxation in our efforts to curb inflationary pressures.

Representative CURTIS. Then let me attack it from another angle. You refer to a record level of plant and equipment outlays. When those outlays have been completed of course that will expand our production so that should relieve inflationary pressures, should it not?

Mr. MARTIN. With the additional supply of goods.

Representative CURTIS. Yes.

Mr. MARTIN. But it tends, particularly if it is unsoundly financed, to some overcapacity, which will have to be adjusted in the market.

Representative CURTIS. Let me put it this way, then: Do you see a continuation of this record high level of investment in new plant and equipment?

Mr. MARTIN. I think that it is likely that we may have it and what we are dealing with here is a condition. This is not something that is brought about by Federal Reserve policy. It is something that is brought about by the demand for funds.

Representative CURTIS. Oh, no; I am not in any sense implying that the policies brought it about at all. I happen to feel that it is an economic situation which we must try to analyze to see how it might be coped with through monetary and credit restrictions. That leads me to my real question, though:

In your presentation, and particularly the statement that you made on page 1, that the primary danger is not one of idle men but is one of too much money, I believe you are referring to what might be termed consumer money or consumer dollars, as opposed to the investment dollars?

Mr. MARTIN. That is it. We debated quite a bit on what term to use in making this statement. We used the phrase "active money" at one time and I objected to that and said let's make it "too much money."

It is a very difficult thing to point out that is a shortage of savings, but at the present time with the pent-up demand that we let loose at the end of the war, people have been borrowing money and spending money considerably beyond their ability to get these items in the market without pushing the price level up.

Representative CURTIS. Maybe then what you mean is too much money which has been generated by too much credit.

Mr. MARTIN. Exactly.

Representative CURTIS. Let me pose it this way: You recognize a differentiation between what some call the consumer dollar and the investment dollar. It can be the same dollar.

Mr. MARTIN. It could be the same dollar, but if you are making an investment you have to make it out of savings. You can't make it out of a borrowing.

Representative CURTIS. Yes; but what might be savings to me could be something that another person would regard as necessary for their objective of living. It is a psychological thing whether you convert a dollar into consumption or into investment, but what I am trying to get out in my final question is this:

Whether in your credit restrictions that you can impose through the Federal Reserve powers the restraint can be applied to what might be called the consumer dollar and liberalized as to what might be called the investment dollar, the dollar that is more likely to go into economic development.

Do you make such a distinction, or do you feel that a distinction can be made in your setting of policies?

Mr. MARTIN. I don't see how you can, in administering a general credit policy, distinguish between types of credit.

Representative CURTIS. We have at times in some of our credit restrictions asked the borrower just what he intended to do with the money. That has been when we had credit controls.

Mr. MARTIN. You can go to direct controls and put the finger on it, but I am talking about now——

Representative CURTIS. I was trying to talk solely on indirect controls, as to whether or not through the controls you do have you can make a distinction on what might be clearly the consumer dollar as opposed to that credit which might be going to investment. For example, as you properly stated, a lot of the financing of some of this plant and equipment has come from bank borrowings instead of new equity capital.

On the other hand, the banks can become restrictive of borrowings by corporations, even though it is going into plant and equipment, which would ultimately ease the inflationary pressure, as opposed to a dollar that is just going out for buying an automobile, let's say.

Mr. MARTIN. That means exercising judgment on the part of the lender.

Representative CURTIS. Yes, of your banks. That is very true.

Mr. MARTIN. Would you object to my letting Mr. Riefler, who has done quite a bit of work on this, give you his comments on this question?

Representative CURTIS. I wish he would as soon as I pose a final one, because this will be the final one.

This morning I asked Secretary Humphrey with respect to the budget surplus, which is only $1.6 billion right now, but in anticipating a budget surplus and applying it on to the Federal debt, to what area of the Federal debt might it be applied. To illustrate what I am driving at, you might apply it on reducing the amount of E-bonds, which are held in smaller quantities by the general public and probably would be converted or could be converted into consumption dollar as opposed to cutting down the amount of bank-held Government securities?

It seems to me there could be an area of policy there that would distinguish between these two types of dollars. Now I will turn it over for an answer.

Mr. MARTIN. I think that the Treasury obviously is up against the problem of selling E-bonds but the market securities would be the ones they prefer to retire, the only ones they could retire with their surplus without going through all the mechanics of calling in an E-bond.

Representative CURTIS. There is such a turnover each year of various kinds of Government securities a policy could be that we would like to have so much of the Federal debt in this kind of security, so much in this. In fact such policies are made. My question is, where the retirement of the Federal debt would be most effective to further our overall objective of growth and stability, if there is such a policy decision that could be made.

Mr. MARTIN. That is a problem that the Treasury should work on continuously, I think.

Representative CURTIS. However, you have no view on that?

Mr. MARTIN. I would feel that we naturally are concerned from the monetary policy standpoint.

Representative CURTIS. That is what I mean.

Mr. MARTIN. And would consult with them, but we feel this is primarily their field and we would try to accommodate ourselves to what their wishes were. If you don't mind I would like to ask Mr. Riefler to comment on it.

Representative MILLS. Mr. Riefler, will you identify yourself for the record?

Mr. RIEFLER. My name is Winfield Riefler, and I am assistant to Chairman Martin at the Federal Reserve Board.

The problem of saving of course involves a restriction of consumption. A saved dollar is something that isn't consumed or isn't spent by the owner of it on consumption, so that to the extent that we actually encourage and increase savings it does make more money available for expansion of the basic plant and equipment of the country.

Representative CURTIS. How do you encourage the savings, yes.

Mr. RIEFLER. That is a difficult problem. With the present powers the Federal Reserve Board has it is something that happens mostly in the market. As interest rates rise people are inclined toward more saving. They tend to stimulate people to save more instead of spending on consumption and thus make funds available to industry. It is a slow process, however.

Representative CURTIS. That is the only area you see where the policy of the Federal Reserve might be effective?

Mr. RIEFLER. Yes.

Representative CURTIS. Thank you very much. That is all.

Representative MILLS. Mr. Martin, on page 2 of your statement in the first full paragraph, the second sentence, you say:

> Given appropriate monetary and fiscal policies, reasonable restraint by consumers and business in their spending decisions, and continuing keen competition, price stability with a rising standard of living can reasonably be expected.

You will recall that in the course of the February hearings on the President's Economic Report I was somewhat concerned as to how consumers and businessmen might exercise appropriate restraint in spending decisions because of the lack of established standards, perhaps by Government, by which they could go. Have we made any progress in that direction through the establishment of standards by consumers or businessmen on their own that gives us any hope that there will be restraint in spending decisions?

Mr. MARTIN. I don't think we have made any progress as far as formal standards are concerned, but I think the problem that we are dealing with has been discussed actively in the press and at various meetings of businessmen and others around the country, and a good deal of thought is being given to it and that in itself, along with policies which I think speak for themselves, such as rising interest, has had some influence in this direction.

Representative MILLS. Do you think there really has been some restraint exercised then by consumers and businessmen in spending decisions?

Mr. MARTIN. I think there has been some, yes.

Representative MILLS. Has there been sufficient restraint? Has it been of enough degree to exercise any real effect upon the situation?

Mr. MARTIN. I don't know.

Representative MILLS. Is there anything further that any of us can do to assist them in the development of standards by which they can judge whether restraint is sufficient or not?

Mr. MARTIN. I don't think there is anything further except the sort of education that comes out of a hearing such as this and other hearings that we are having, and people facing up to the problem. It is pretty difficult to prescribe standards with as many types of business and as many types of individuals as we have in a country of this sort, but if you keep hammering away at the fundamentals and they are faced with the decisions of the market, day by day, I think that you make considerable progress and it seems to me in the last few months, while I can't say that I think that things have been handled perfectly, I think that there has been some progress.

Representative MILLS. Last Tuesday a question was raised in the course of our hearing as to whether or not the Federal Reserve System's policy of restricting growth in the supply of credit was being offset by an increase in velocity; that is, the rate of the turnover of the supply of money and credit.

Is there some possibility that velocity changes our offsetting your policy of restricting supply of credit?

Mr. MARTIN. We have been trying to take that into account. Let's put it this way: We feel that the money supply should increase for normal growth. We have used a figure of 3 or 4 percent. That has been discussed at great length in the press and other places as the normal growth. The money supply last year expanded at the rate of about 1 percent, but the velocity of money increased about 8 percent. We took that into account.

We took that into account in measuring our supply of money. We have never at any time wanted to destroy what we believe to be sound prosperity. Our efforts are never directed toward restraint just for restraint's sake and we don't think that monetary policy ought to be used aggressively to restore a price level that may be out of balance. We think that monetary and credit policy should be allowed to operate on supply and demand factors and then the decisions of the market decide whether demand can be sustained at this particular price level.

Representative MILLS. Is it your contention then from your position that fiscal policy itself should be used to prevent further price increases?

Mr. MARTIN. I think all policies should be directed toward that, but I think you have to depend there on fiscal policy, debt management policy, and money and credit policy. I don't think you can isolate it.

Representative MILLS. Your point is we should have not had to depend entirely on monetary policy?

Mr. MARTIN. That is right.

Representative MILLS. We should depend on a combination of all of the policies.

Mr. MARTIN. Yes.

Representative MILLS. That they should all be directed toward the same end?

Mr. MARTIN. That is right.

Representative MILLS. You have said, I think repeatedly, that we cannot look to monetary policy to halt price rises by itself.

Mr. MARTIN. That is right.

Representative MILLS. Do you still insist that that is true?

Mr. MARTIN. I still insist that is correct.

Representative MILLS. So then if we are to have a halt in price rises we must exercise better fiscal policy or inject into fiscal policy more decisions for debt retirement? Is that your point?

Mr. MARTIN. That is my point.

Representative MILLS. In other words, that we not use prospective surpluses that may develop in the course of a few months ahead of us for tax reduction, but rather use those for debt retirement?

Mr. MARTIN. That is correct.

Representative MILLS. You say further on page 2 in that same paragraph:

> On the other hand, acceptance of the gradually rising price theory carries with it a widening expectation of further rise. This leads in turn to financial overcommitments, speculation, misdirected expansion of capacity, slackened efficiencies, erosion of existing savings and discouragement of new savings, and an ultimate reaction of a serious nature.

Is there any evidence today of financial overcommitments, speculation, misdirected expansion of capacity, slackened efficiencies, erosion of existing savings, and discouragement of new savings? Do we have evidence of such a situation today?

Mr. MARTIN. Yes. I definitely think there is.

Representative MILLS. Does that mean, then, we have existing evidence of the fact that inflation for this year may be snowballing?

Mr. MARTIN. The best way I can put that is, what we are dealing with when we are talking about inflation is a process. We are talking about a spiral, we are talking about a cancer, and it isn't something that once it starts—and it has been operating for the last 18 months—you halt by isolating one little segment of it. Indeed, it has been rolling along here, and there have been adjustments taking place, rolling adjustments, which I think have been healthy. We have seen it in the housing field. We have seen it in the automobile business. We have seen it in the textile field. Not every business has been making hay persistently. There have been adjustments carrying along right straight through this. The thing we don't want to do is have all those adjustments come at the same time.

Representative MILLS. We were told last week, Mr. Martin, by some of these non-Government witnesses, that the buoyancy in the economy was not as great now as it had been but that there was still zip left in it, that if we were not careful we would bring about greater inflation, but I was sleeping better last week as a result of what these experts said because I thought they meant that perhaps the threat of inflation for the remainder of this year was not as pronounced or as great as the threat of inflation for the remainder of 1956 was at this time last year.

I hope you are not going to cause me to lose a night's sleep now by putting yourself in contradiction to what they said last week. Maybe I have misunderstood you, but I have understood you so far to mean that these factors which give rise to further inflation are now evident and since they are evident, if we do not exercise greater restraint in fiscal and monetary policy we may be going through the same situation for the remainder of this year that we went through for the latter part of last year.

Mr. MARTIN. All I can say, Mr. Chairman, on that is that I didn't study the comments of the economists you refer to, and most of them are probably wiser than I am, but I don't know. I won't forecast on the balance of the year. I would merely call attention to the fact that in February there were a great many economists that saw collapse just around the corner. Business sentiment has gone up and down in waves. At the moment my guess is that business sentiment is improving, but I don't think it is sentiment alone that makes business. I think we have to deal with these fundamentals. While I don't want you to lose any sleep, I can assure you that I am trying to get a good night's sleep so I can worry effectively in the daytime. But all of us ought to be worried about this and ought not to be complacent about this and certainly the Federal Reserve Board—I am speaking for them here—has no sense of complacency, as I said to you in February.

Representative MILLS. You will recall that in February I raised the question with you, Mr. Martin, as to whether or not in the short run we could achieve stability in the price level and a high rate of economic growth, and I believe your answer then was "yes." Have events so far this year changed your views in any respect?

Mr. MARTIN. No, they have not changed my view at all. I think we can.

Representative MILLS. We have been told, however, that the growth in real output so far this year has been very modest while, as you know, prices have continued to rise.

Does this suggest to you the possibility that with present public policy, stable prices and growth in real terms may not always be mutually consistent in the short run?

Mr. MARTIN. In the short run; yes.

Representative MILLS. We have been experiencing such a situation, have we not, in recent months?

Mr. MARTIN. That is right.

Representative MILLS. A number of people have presently claimed, I think taking their cue from what was said in the President's economic report in February of this year, that we now are experiencing a different kind of inflation, a cost-price push inflation instead of traditional inflation resulting from excessive demand. They argue that important sectors of industry and labor are insulated from public policies which are directed to restraining total demand, so that monetary restraints, for example, which result in higher interest costs do not serve to cut back the rate of spending or to prevent increasing prices.

It is further argued that this being the case public restraints impose too heavy a burden on weak elements in the economy.

Finally, it is argued that relaxing these restraints will have little consequences so far as inflationary price and cost movements are concerned. Do you have any views with respect to these arguments?

Mr. MARTIN. I am inclined to think that all of those arguments are specious. They all have a grain of truth in them, but I doubt very much whether in the overall they are accurate. I am more and more convinced, as I said at the time of our February meeting, that we still have a lot to learn in this field. I don't say that out of any mock sense of humility.

I think we are doing everything we can in the Federal Reserve to follow this, but when you isolate any of the elements that are put together in that statement and try to analyze them, there are individual instances that will confirm it, but when you take the overall it is by no means an open-and-shut case to me that any of the doubts or questions that have been raised are necessarily correct.

I am not disposed to say that there isn't some truth in all of them, but I am talking about it in an overall sense and I think what we are dealing with in the broad pattern is what the alternatives are in the way of tackling each of these situations, how you do it.

Representative MILLS. The fact remains, does it not, Mr. Martin, that even if they should be correct in their statement that this is different from the traditional type of inflation, there seems to be no other way of restraining whatever it is we have today, except that we exercise some restraint upon demand; is that not true?

Mr. MARTIN. Exactly.

Representative MILLS. So that you don't get around the basic problem today by these arguments that are made about this situation by suggesting that since it is something other than traditional inflation there is no need to worry about restraints in monetary or fiscal policy that affect demand?

Mr. MARTIN. I agree with you completely.

Representative MILLS. Of course you and I recognize that if we don't exercise the restraint in fiscal and monetary policy upon demand we ultimately, if we are to control the situation, would have to revert to direct controls, which none of us wants.

Mr. MARTIN. Exactly.

Representative MILLS. So that those who advocate this philosophy may well be bringing about the time when we would have to impose direct controls, which none of us would want and the people certainly would not want.

Mr. MARTIN. Absolutely.

Representative MILLS. I will ask you: Should they not then better go along regardless of the type of inflation we have with such restraints as are needed to bring about stability in the general price level?

Mr. MARTIN. I most certainly agree.

Representative MILLS. Fine. Let me get to this question of the relationship of our monetary and fiscal policies and what we impose upon you in handling monetary policy if we do not exercise responsibility in the establishment of fiscal policy.

It has been suggested several times that the Congress should endeavor to enact tax reduction legislation some time next year that would affect a part of the fiscal year 1958. We have had testimony from many witnesses, including the Secretary of the Treasury and the Director of the Bureau of the Budget, expressing the thought that possibly on the basis of what we now know there will not be very much of a surplus in fiscal 1958 out of which a general tax reduction can be carved. If we should in our zeal for tax reduction create a situation wherein fiscal policy would not exercise restraining influences by the budget being unbalanced or being so slightly in the black as to have little effect, what do we then do to your job of trying to control these increases in prices? Do we make it more difficult? Do we make it impossible? Can we do these things and rely upon you through the Federal Reserve to control the effects from our pouring oils on the fires of inflation?

Mr. MARTIN. You make it infinitely more difficult for us.

Representative MILLS. It is possible then that we create a situation that you cannot handle, is that it?

Mr. MARTIN. We would do our best, but I think it might be well nigh impossible.

Representative MILLS. If we do create a situation that makes it impossible for you to handle inflation, if we do create a situation that you cannot handle, say, or handle properly even, it may be that we will feed inflationary pressures to such an extent as to bring about so much more inflation as to offset any gains that will be intended through tax reduction?

Mr. MARTIN. There is no question about it in my judgment.

Representative MILLS. Is it your opinion, therefore, as you view the situation from your position, that it would be wise for the Congress not to consider now or in the few months ahead a tax reduction in fiscal 1958 except as it may be possible for Congress to reduce spending in 1958? We might return that to taxpayers.

Mr. MARTIN. That would be my considered judgment.

Representative MILLS. Unless there is a reduction in prospective spending then. From your point of view it would be better not to reduce taxes?

Mr. MARTIN. That is correct.

Representative MILLS. Of course we are thinking solely in terms of continuing conditions such as we have and not a downturn in activity.

Mr. MARTIN. Yes; I was assuming that in answering your question.

Representative MILLS. Of course, as the Secretary of the Treasury said this morning, that is a horse of a different color. If we get to that all these things we are talking about would have to fade. Do you have anything further?

Representative CURTIS. Yes.

Representative MILLS. Mr. Curtis.

Representative CURTIS. Mr. Mills asked this question about whether you could handle the inflationary forces or whether your problem of handling them would be made more difficult by the various things he suggested. I was just wondering if you would care to comment as to whether you felt that you had been able to handle these forces in the past 18 or 24 months.

Mr. MARTIN. I will have to say that we have wrestled with them continuously, but I can't give us a hundred percent for effectiveness or efficiency.

Representative CURTIS. Prices have risen.

Mr. MARTIN. They have, indeed.

Representative CURTIS. And it looks like they will continue to rise for the next few months. In other words, you would say that the present forces, or the forces that have been in existence just recently, have been more than you have been able to cope with?

Mr. MARTIN. I would say they have gotten a little bit ahead of us over the last 18 months.

Representative CURTIS. Thank you.

Representative MILLS. Mr. Martin, in the event that there is some downturn in business activity in the few months ahead that constitute the calendar year 1958 should we immediately proceed to adjust fiscal policy to take account for that, or should we first proceed with a relaxation of such monetary controls as we now have and restraint as we now have before doing anything with respect to fiscal policy?

Mr. MARTIN. I think that a judgment has to be made on the seriousness of the decline.

If you assume that it is a very serious decline, the tide has definitely turned and now deflation is in the ascendency I would think that you would want to use both weapons to cushion the decline.

Representative MILLS. However, would you want to use fiscal policy before the Federal Reserve did anything about the easing of monetary restraints?

Mr. MARTIN. I think the chances are that we are more flexible then fiscal policy and chances are we would operate before you would get a change in fiscal policy.

Representative MILLS. I don't know. I imagine if you give the Congress the sign on tax reduction they would be very quick to follow.

Mr. MARTIN. They might run faster than we would. I agree with you on that.

Representative MILLS. We are all very anxious to find the time when we can reduce taxes and we have been somewhat stymied as we proceed with these hearings to believe that now is the time to do that. I thought perhaps if we had some downturn in business activity during the course of the year we might use that as a justification, if you thought it was appropriate for us to act more promptly than the Federal Reserve would with respect to monetary restraint.

Mr. MARTIN. I would be cautious about suggesting that at the first sign of a downturn we ought to rush in with every weapon we have to prevent adjustments.

Representative MILLS. I was somewhat facetious of course in the statement, but there is the threat always that the least downturn in the business activity in the months ahead may be utilized as a basis for tax reduction and I raised my question initially very seriously to point out through you if I could that we should first test relaxation of monetary restraints to see whether or not the relaxation of those restraints was sufficient to avert a further downturn and then if that did not work we could then consider adjusting fiscal policy in the interest of preventing a further downturn.

Would that be sound or unsound?

Mr. MARTIN. I would be inclined to think it would be sound, but I want to point out on this matter of adjustments that neither fiscal policy nor monetary policy will prevent adjustments that will be brought about at some time from excesses. They may cushion a decline, but in my judgment they will be totally ineffective as far as preventing declines if the excesses that precede call for adjustments in prices and demand and supply factors that have to be made.

Representative MILLS. What you are saying I think is this: That if we do not use better policy or more restraint ourselves to avoid further inflation, those rises in and of themselves may create the situation that when business does turn down, if it does, we may find ourselves in the position of being unable to avoid further downturn, whatever we do through monetary policy or fiscal policy.

Mr. MARTIN. That is correct.

Representative MILLS. Therefore, it is the big job for us today to try to prevent further rises in prices and further spread of inflationary forces?

Mr. MARTIN. That is correct. To put it in terms of the Employment Act, the goals of the Employment Act in my considered judgment can be attained at the present time only through resisting inflation.

Representative MILLS. I think you are exactly right, so that then fiscal policy as we suggest what it should be, should be then formulated to assist in the control of these inflationary pressures first?

Mr. MARTIN. Exactly.

Representative MILLS. And in the process if we do that it will be easier then for you to supply the additional assistance that is needed through monetary policy to bring about their complete control?

Mr. MARTIN. That is correct.

Representative MILLS. Do you have any further questions?

Representative CURTIS. No.

Representative MILLS. Mr. Martin, we appreciate so much your appearance and the information you have given the committee. You are always very helpful. We know your schedule is quite full. We thank you and Mr. Riefler very much for coming here.

Mr. MARTIN. I am very glad to be here.

Representative MILLS. This concludes the present hearings. The committee will adjourn subject to call of the Chair.

(The following material was supplied for the record by the Treasury Department, at the request of the chairman:)

THE PUBLIC DEBT AND ITS MEANING

The purpose of this memorandum is to discuss briefly some of the most important aspects of the public debt of the United States and to bring it into perspective with the environment in which it constitutes a major influence.

I. DEFINITIONS OF THE PUBLIC DEBT

The public debt of the United States may be defined as the total amount of borrowing now outstanding which has been necessary to cover the accumulated excess of expenditures of the Federal Government over receipts during the 168 years of our life as a Nation. From George Washington's inauguration in 1789 through the end of the calendar year 1956 the United States Government has spent $1,115 billion. About three-fourths of this $1,115 billion was paid for out of taxes, customs, or other Federal Government receipts. The rest of the money was borrowed. As a result, the public debt at the end of calendar year 1956 amounted to $277 billion.[1]

In popular usage, the terms "public debt," "national debt," and "Federal debt" are interchangeable. Technically speaking, the term "public debt" customarily applies only to the direct obligations of the United States Treasury, backed by the full faith and credit of the United States. With the increased use of the financing of wholly owned Government corporations during the 1930's through the issuance of agency obligations which were guaranteed as to principal and interest by the United States Government, these were added to the direct debt figures to provide a more complete statement of the national debt. Most of these guaranteed issues were refunded into direct debt at maturity and there are only about $100 million of guaranteed obligations now outstanding (mostly Federal Housing Administration debentures).

The debt as thus defined does not include those obligations of Government agencies which are not guaranteed. The amount and nature of these will be discussed later.

In recent years the concept of the public debt has usually referred to the gross direct public debt, plus guaranteed obligations of the United States outstanding outside of the Treasury. The term "public debt" in its usual sense applies to the debt of the Federal Government and excludes State and local government debt.

More than $274 billion of the public debt outstanding (99 percent) is interest-bearing debt. The total of $277 billion also includes $1½ billion of debt which bears no interest (mostly notes issued to the International Monetary Fund) and almost a billion dollars of matured debt on which interest has ceased. Although most of this matured debt will eventually find its way back to the Treasury for redemption over the years, some of it is permanently lost or destroyed. There is no statute of limitations applying to public debt obligations, so it remains as part of the public debt—even including more than $50,000 of Treasury stock which was issued in 1790.

The public debt subject to legal limit[2] as of December 1956 was $276.3 billion. The difference of slightly less than one-half billion dollars as compared with the total debt is accounted for by obligations issued prior to the enactment of the Second Liberty Bond Act in 1917, including currency items in the debt (mainly United States notes not secured by gold, and deposits for retirement of national and Federal Reserve bank notes) and Panama Canal bonds. The public debt limit at the present time has been fixed temporarily by the Congress at a maximum of $278 billion, but that limit will expire June 30, 1957, when the limit of $275 billion will again apply.

All obligations included in the public debt are stated in terms of par (or maturity) value with the exception of United States savings bonds of series E, F, and J. Of these issues interest accrues until the bond has matured or is redeemed, rather than being paid currently, and they are included in the public debt on the basis of current redemption values (issue price plus accrued interest).

A "net" public debt is sometimes computed by taking the total debt outstanding and subtracting the Treasurer's cash balance. This is particularly useful in measuring the net impact of the debt during periods of wide swings in the cash balance, as was true during and immediately after World War II. Since the Treasurer's cash balance on December 31, 1956, amounted to $4.4 billion, the "net" debt so computed on that date would be $272.3 billion.

Although the Government does not publish an overall balance sheet there is, of course, a large volume of assets that might be considered in relation to our public debt liabilities. For example, the House Committee on Government Operations recently published a report that showed that total Federal Government assets on June 30, 1956, amounted to $235 billion, with the value determined on a number of different bases. This total included cash, loans and investments, commodities, military equipment, real property (including public domain), and various other assets.

[1] Unless otherwise cited, all figures in this memorandum are as of December 31, 1956.
[2] Limitation on outstanding debt issued under Second Liberty Bond Act, as amended.

Another concept of the Federal debt which is regularly published by the Federal Government is included in the Department of Commerce's study of public and private debt. These data on Federal debt are presented both on a gross and net basis. The Commerce figure on gross Federal debt of $300 billion takes the Treasury's public debt concept and adds the borrowing of Federal agencies from the Treasury as well as the public. Thus the Commerce Department concept of gross public debt includes the more than $20 billion which the agencies have borrowed from the Treasury as well as the $20 billion which the Treasury has had to borrow from the public to supply the cash needs arising from agency operations. The Commerce Department gross debt concept also includes any borrowing done by agencies like the Federal National Mortgage Corporation, Federal home-loan banks, which borrow directly in the market, even though those obligations are not direct or guaranteed obligations of the United States Government. The Commerce Department analysis recognizes, however, that $75 billion of this $300 billion debt is either held by the Treasury or by Government investment accounts so that its figures on net Federal debt are approximately $225 billion as of last December.

A closely associated concept of the Federal debt is implicit in the material which the Treasury and the Budget Bureau regularly prepare on the Federal Government's cash income and outgo (or Federal Government cash receipts from and payments to the public). Under this concept only cash borrowing from the public in the first instance is considered. The total cash borrowing on this basis of $217 billion as of last December therefore excludes such essential parts of the Government's obligations as the accrued interest on savings bonds as well as securities held by Government investment accounts.

All of these concepts have a degree of usefulness for specific purposes. (See exhibit A–1 for further detail.) From the standpoint of the Treasury, however, the accepted statement of the public debt liability is the public debt as defined earlier, amounting to $276.7 billion as of last December.

II. THE CHARACTERISTICS OF THE PUBLIC DEBT

Having defined the public debt as in essence the accumualtion of budget deficits over surpluses since the Nation's beginning, the next step in the analysis involves the basic characteristics of the debt. The public debt on December 31, 1956, amounted to $276.7 billion (on May 22, 1957—lates date available—this total was down seasonally to $272.7 billion).

In its current financing operations (both cash and refunding) the volume of Federal Government offerings exceeds that of all other security offerings and new mortgage recordings combined.

The public debt is equal to $1,631 for every man, woman, and child in the United States. It is equal to 79 percent of the national income of the United States, and it represents 35 percent of the total of the $784 billion of gross public and private debt outstanding in the United States today. It is larger in relation to national income than the public debt of Canada (79 percent as against 64 percent), but is much smaller than in the case of the United Kingdom (166 percent).

The public debt may be broken down in a great many ways. About $160½ billion of the debt as of December 31, 1956, was in marketable obligations, consisting of $21 billion of regular 91-day bills, about one-thirteenth of which come due each week; $4½ billion of tax anticipation and special issues of bills; $4½ billion of tax anticipation certificates of indebtedness; $14½ billion of certificates of indebtedness (up to 1 year of original maturity); $35 billion of Treasury notes (1 to 5 years); and $81 billion of Treasury bonds (over 5 years). The Treasury fixes at time of issue the rates of interest on Treasury certificates of indebtedness, notes, and bonds but the rate of interest (discount) paid on Treasury bills is determined by bidders in the bill auctions rather than by the Treasury.

About $56½ billion of the debt is in nonmarketable United States savings bonds, with $41½ billion of it in the form of the small-saver series E and H bonds. Another $11½ billion is in Treasury nonmarketable investment bonds, and $45½ billion in special issues to Government agencies and Treasury funds like social security, veterans life insurance, Federal employees' retirement, etc. These special issues of public debt securities are available only to certain Government accounts. They are internal in character and are used mainly to avoid frequent disruptions in the Government securities markets growing out of the large volume of market investment transactions that would otherwise be necessary for Government accounts. In some cases the interest rates on the special issues are set by statute; in others the Secretary of the Terasury establishes the rates, giving effect to the legal basis of the funds and the fact that the special issues are redeemable at par when cash is needed in the accounts.

The remainder of the debt consists of matured debt on which interest has ceased, debt bearing no interest, and guaranteed Federal Housing Administration debentures issued on default of mortgages. (See exhibit A–2 for further detail.)

The marketable debt of $160½ billion is commonly classified by maturity structure to give some idea of the amount of short- versus long-term debt. As of December 31, 1956, $68½ billion of this debt would come due during calendar year 1957; $41 billion would come due in 1958–61; $18 billion in 1962–66; and $33 billion after 1966 (more than 10 years to maturity).

With a substantial part of the Federal debt consisting of fairly long-term obligations, the average rate of interest on the public debt responds only slowly to current changes in interest rates. As of December 31, 1956, the average rate of interest on the Federal debt was 2.67 percent, which represents a computed interest charge of $7.3 billion on an interest-bearing debt of $274.3 billion. This computed interest charge of 2.67 percent compares with 2.06 percent 10 years ago. However, the burden of public debt interest costs in relation to national income has declined from 2.8 percent in December 1946 to 2.1 percent in December 1956.

Although the public debt is usually thought of in its role as a liability of United States Government it is, on the other hand, an asset to the thousands of insitutional and corporate investors and to the millions of individuals who own the securities.

As of December 31, 1956, $54 billion of the debt was held by Government investment accounts—mostly trust accounts. The funds coming into these accounts are practically all invested in Government securities in accordance with law. These securities are, of course, just as much a part of the public debt as any securities held by private trust funds or any other investor.

About $25 billion of Federal securities are held by Federal Reserve banks. Along with the Nation's gold stock they provide the assets which support the Nation's money supply. About $59½ billion of the debt is held by commercial banks. During the last year a smaller proportion of the debt has been held by commercial banks than at any time since the mid-1920's. About 36 percent of the earning assets of commercial banks are now invested in Government securities.

The remaining $138½ billion of the debt is held by private nonbank investors. The largest single segment is represented by the $66½ billion held by individuals (including personal trust accounts)—three-quarters of it in savings bonds. This represents 25 percent of all liquid assets held by individuals (including savings accounts, savings and loan shares, checking accounts and currency as well as Federal securities).

Insurance companies own $13 billion of Federal securities, representing 11 percent of their assets. Mutual savings banks hold $8 billion and that accounts for 24 percent of their assets. About 6 percent of the assets of savings and loan associations are in Governments, as are about 41 percent of the assets of State and local retirement funds, 17 percent of the assets of corporate pension trust funds, and a significant share of the assets of State and local general and sinking fund, and nonprofit institutions. Corporations other than banks and insurance companies hold $19 billion Government securities, representing 9 percent of total corporation current assets (including also cash, receivables, and inventories).

About 97 percent of the debt is domestically owned; the $7½ billion held abroad includes United States Government securities owned by institutions such as the International Monetary Fund, foreign central banks, or commercial banks and foreign governments. Although information is sketchy on holdings of Federal debt by foreign investors outside of these groups they are not large. (See exhibit A–3 for further data on debt ownership.)

Of the $7 billion of interest paid on the public debt during calendar year 1956, $1.4 billion represented the payment of interest to social security funds and other Government investment accounts. About $0.6 billion of public debt interest was received by the Federal Reserve banks, 90 percent of which, in effect, was returned to the Treasury as surplus earnings. Commercial banks received approximately $1.4 billion of interest last year. About $0.6 billion went to other financial institutions (mostly insurance companies and savings banks), $0.5 billion to corporations, $0.4 billion to State and local governments, and $0.4 billion to nonprofit institutions, foreign accounts, etc. The remainder of about $1.8 billion—the largest single segment of the interest on the public debt—went to individuals, either in the form of cash payments or accumulated interest on savings bonds.

III. EXCLUSIONS FROM THE PUBLIC DEBT

There are other Federal Government commitments, contingent liabilities, potential expenses, and potential income which are not reflected in the public debt. The public debt does not include loans guaranteed or insured by Government agencies, Government insurance in force, certain obligations issued on the credit of the United States, or undisbursed commitments to meet future loans.

Many of these are programs of a long-range nature that may never involve an actual Government expenditure. The extent to which the Government may be called upon to meet these commitments varies widely. In many cases, billions of dollars of contingencies of this nature have been outstanding for many years without a cent of Government expenditures involved which would add to the public debt. The liability of the Government and the ultimate disbursements to be made are dependent upon a wide variety of factors, including the nature of and the value of assets held against the commitments, and—most important—the overall economic health of the Nation.

There is, for example, $40 billion of loans guaranteed or insured by Government agencies—mostly in the housing field. There is also $209 billion of Government insurance of bank deposits, savings and loan association shares and the veterans insurance programs. These insurance programs have reserves either directly or indirectly in the form of Government securities in the amount of $75 billion which are already included in the public debt.

Similarly, the Government has an obligation for the payment of postal savings certificates which are issued on the credit of the United States. This obligation of $1.6 billion is, however, offset by securities which the Postal Savings System owns—securities which are already in the public debt. Similarly, the Treasury has contingent obligations to pay Federal Reserve notes in the face amount of $27½ billion, but that obligation is more than covered by the holdings of public debt securities and the gold certificate reserves by the Federal Reserve banks. The Government also has contingent liabilities in connection with several billion dollars on guaranteed and insured loans of various types and the payment of further subscriptions to the International Bank for Reconstruction and Development. (See exhibit B for further discussion.)

There are other Federal Government liabilities, not included as contingencies, such as those arising under appropriations and other authorizations involving the obligation and expenditure of funds for bugetary purposes. On June 30, 1956, unexpended balances under these appropriations and authorizations amounted to $72.9 billion, of which $35.5 billion represented unobligated balances and $37.4 billion unliquidated obligations. These potential claims on the Government, a large share of which has not yet reached the status of accounts payable, cannot be considered apart from the fact that the Government also has large amounts of taxes receivable.

In a more imaginative sense, the list of potential liabilities of the Federal Government could be expanded further to indicate commitments to pay interest from now to maturity on all public debt obligations outstanding, to pay future social security benefits, railroad retirement benefits, and Federal employee benefits for an indefinite period, etc.

Although the responsible exercise of the taxation powers of the United States Government in a growing economy will help insure that these contingencies can be handled adequately should the occasion ever arise, sound fiscal policy nevertheless requires that the authority to incur future Federal Government commitments be used with utmost care.

Although the public debt does include all borrowing required to cover the needs of Federal departments and agencies generally it does not include borrowing which some Federal business-type enterprises are permitted to do directly in the market.

These obligations are not guaranteed as to principal or interest by the United States Government. Such obligations amounted to $2.6 billion at the end of December 1956, reflecting borrowings by the Federal Home Loan Banks, the Federal National Mortgage Association, and certain farm credit agencies. Each of the agencies involved in borrowing of this type is engaged in a business-type activity where traditionally borrowing has been done directly from the market to emphasize their independent nature and their ability to stand on their own feet. In some cases Government funds are no longer involved—either in the form of capital or loans. (See exhibit C for further detail.)

In order to round out this discussion of the public debt, a number of exhibits have been prepared. They consist of—

A. The public debt as of December 31, 1956:
 1. Definitions of the debt.
 2. Composition of the debt.
 3. Ownership of the debt.
B. Long-range commitments and contingencies.
C. Nonguaranteed Federal agency debt.
D. Legislative authority relating to the public debt.

There are attached also copies of the Daily Statement of the United States Treasury as of December 31, 1956, and April 30, 1957, which contain more complete detail on public-debt transactions, public debt outstanding, guaranteed obligations, and borrowing from the Treasury by Government corporations and other agencies. Also attached is a copy of the May 1957 Treasury Bulletin, presenting further information on the debt, new offerings, disposition of maturities, ownership, and composition, with comparative data for other recent years. Several tables are also attached which are excerpts from the Annual Report of the Secretary of the Treasury for the fiscal year ending June 30, 1956, giving broad historical data on the public debt.

Source: Office of the Secretary of the Treasury May 29, 1957.

EXHIBIT A-1

The public debt, Dec. 31, 1956, under various definitions

[In billions of dollars]

1. Direct debt versus guaranteed obligations:	
Direct debt	276.6
Quaranteed obligations held outside Treasury	.1
Total public debt	276.7
2. Interest bearing versus noninterest bearing:	
Interest bearing	274.3
Noninterest bearing	2.4
Total public debt	276.7
3. Public debt subject to legal limit:	
Total public debt	276.7
Less: Currency items [1] and Panama Canal bonds	.5
Debt subject to limit	[2] 276.3
4. Public debt net of cash balance:	
Total public debt	276.7
Less: Treasurer's cash balance	4.4
Debt, net of cash	272.3

See footnotes at end of table.

The public debt, Dec. 31, 1956, under various definitions—Continued

[In billions of dollars]

5. Debt as defined by Department of Commercial material on public and private debt:	
(*a*) "Gross" debt:	
Total public debt	276.7
Federal agency debt—	
Owed to Treasury	21.0
Owed to public (nonguaranteed)	2.6
Notes payable, etc	.1
Total "gross" debt	300.5
(*b*) "Net" debt:	
Total public debt	276.7
Less: Holdings by Government investment accounts	54.0
	222.7
Plus:	
Nonguaranteed agency debt	2.6
Agency notes payable, etc	.1
Total "net" debt	225.4
6. Net "cash" borrowing from the public:	
Total public debt	276.7
Less: Holdings by Government investment accounts	54.0
	222.7
Less:	
Savings bond interest accruals [3]	7.2
Discount on Treasury bills	.2
International Monetary Fund notes	1.1
	214.2
Plus: Nonguaranteed agency debt	2.6
Net "cash" borrowing from the public	216.8

[1] United States notes less gold reserve, National and Federal Reserve bank notes assumed by the United States on deposit of lawful money.

[2] Current temporary maximum limit is $278 billion, but limit will return to limit of $275 billion on June 30, 1957.

[3] Includes minor amounts of Armed Forces leave bonds and adjusted service certificates.

NOTE.—Detail will not necessarily add to totals because of rounding.

EXHIBIT A–2

Composition of the public debt, Dec. 31, 1956

[In billions of dollars]

Type of security	*Amount outstanding*
Marketable:[1]	
Bills:	
Regular	20.8
Tax anticipation (including special)	4.4
Certificates:	
Regular	14.5
Tax anticipation	4.5
Notes	35.3
Bonds	80.9
	160.4
Nonmarketables:	
E and H savings bonds	41.4
Other savings bonds	14.9
Convertible investment bonds	10.8
Other investment bonds	.9
Depositary bonds	.3
	68.2
Special issues to Government investment accounts:	
Old-age and survivors' insurance	19.2
Unemployment	8.1
Civil service retirement	7.2
Veterans' life insurance	6.7
Railroad retirement	3.5
All other	.9
	45.6
Miscellaneous:	
Special notes to International Monetary Fund	1.1
Other non-interest-bearing debt	.5
Matured debt on which interest has ceased	.9
Federal Housing Administration debentures	.1
	2.5
Total public debt	276.7

[1] Marketable debt may also be classified by maturity date as follows:

Under 1 year	68.6
1 to 5 years	41.0
5 to 10 years	17.9
10 years and over	32.9
Total	160.4

93528—57——23

EXHIBIT A-3

Ownership of the public debt, Dec. 31, 1956

	Amount held		Percent of assets held in Federal securities [1]
	Billions of dollars	Percent	
Government investment accounts:			
Special issues	45.6	17	
Public issues	8.4	3	
Total	54.0	20	
Federal Reserve banks	24.9	9	
Private financial investors:			
Commercial banks:			
Federal Reserve members:			
Central Reserve city banks	8.3	3	27
Reserve city banks	17.6	6	33
Other banks	22.4	8	41
Nonmenber banks	11.1	4	42
Total, commercial banks	59.4	21	36
Life-insurance companies	7.5	3	8
Other insurance companies	5.3	2	24
Mutual savings banks	8.0	3	24
Savings and loan associations	2.8	1	6
State and local pension-trust funds	4.9	2	41
Corporate pension trust funds	2.8	1	17
Total, private financial investors	90.7	33	23
Other investors:			
Individuals (including personal trusts):			
E and H savings bonds	41.4	15	
Other savings bonds	8.7	3	
Marketable securities, etc	16.5	6	
Total, individuals	66.6	24	
Nonfinancial corporations	1902	7	
State and local governments [2]	10.8	4	
Nonprofit institutions, etc	2.7	1	
Foreign and international accounts	7.7	3	
Total, other investors	107.0	39	
Total, public debt	276.7	100	

[1] Total earning assets in the case of commercial banks.
[2] Other than pension-trust funds.

EXHIBIT B

LONG-RANGE COMMITMENTS AND CONTINGENCIES OF THE UNITED STATES GOVERNMENT AS OF DECEMBER 31, 1956

The attached statement covers the major financial commitments of the United States Government, except the public debt outstanding and those involving recurring costs for which funds are regularly appropriated by the Congress and are not yet obligated, such as aid to States for welfare programs and participation in employee-retirement systems. The statement is segregated into four categories, namely (*a*) loans guaranteed and insured by Government agencies, (*b*) insurance in force, (*c*) obligations issued on credit of the United States, and (*d*) undisbursed commitments, etc.

Caution should be exercised in any attempt to combine the amounts in the statement with the public debt outstanding for that would involve not only duplication, but would be combining things which are quite dissimilar. As indicated by the enclosed statement, there are $101.8 billion of public debt securities held by Government and other agencies as part of the assets that would be available to meet future losses. The following examples illustrate the need for extreme caution in using data on the contingencies and other commitments of the United States Government.

1. The Federal Deposit Insurance Corporation had insurance outstanding as of December 31, 1956, amounting to $121 billion. The experience of the Federal Deposit Insurance Corporation has been most favorable. During the period this Corporation has been in existence, premiums and other income have substantially exceeded losses which has permitted the retirement of Treasury and Federal reserve capital amounting to $289.3 million (all repaid to Treasury), and the accumulation of $1.7 billion reserve as of December 31, 1956. The Corporation's holdings of public debt securities as of that date amounted to $1.8 billion which already appears in the public debt total. Out of $241.4 billion of assets in insured banks as of December 31, 1956, $63.5 billion are in public debt securities (also reflected in the public debt). The assets, both of insured banks and the Federal Deposit Insurance Corporation, as well as the continued income of the Corporation from assessments and other sources, stand between insured deposits and the Government's obligation to redeem them.

2. The face value of life insurance policies issued to veterans and in force as of December 31, 1956, amounted to $43.6 billion. This does not represent the Government's potential liabilities under these programs since some of these policies will probably be permitted to lapse and future premiums, interest, and the invested reserves amounting to $6.7 billion of public debt securities should cover the normal mortality risk.

3. Under the Federal Reserve Act of 1913, as amended, Federal Reserve notes are obligations of the United States which as of December 31, 1956, amounted to $27.5 billion. The full faith and credit of the United States is behind the Federal Reserve currency. These notes are a first lien against the $52.9 billion of assets of the issuing Federal Reserve banks which includes $24.9 billion of Government securities already included in the public debt. These notes are specifically secured by collateral deposited with the Federal Reserve agents which as of December 31, 1956, amounted to $17.6 billion in Government securities and $11.6 billion in gold certificates.

Long-range commitments and contingencies of the U. S. Government as of Dec. 31, 1956

[In millions of dollars]

Commitment or contingency and agency	Gross amount of commitment or contingency	Public-debt securities held by Government and other agencies
Loans guaranteed or insured by Government agencies:		
Agriculture Department:		
Commodity Credit Corporation	[1] 791	
Farmers' Home Administration:		
Farm tenant mortgage insurance fund	[2] 146	
Commerce Department:		
Federal Maritime Board and Maritime Administration	20	(3)
Export-Import Bank of Washington	31	
Housing and Home Finance Agency:		
Federal Housing Administration:		
Property improvement loans	[4] 296	50
Mortgage loans	19, 432	412
Office of the Administrator:		
Urban renewal fund	67	
Public Housing Administration	2, 857	
International Cooperation Administration:		
Industrial guaranties [5]	96	
Small Business Administration	20	
Treasury Department:		
Reconstruction Finance Corporation (in liquidation)	[6] 10	
U. S. Information Agency:		
Informational media guaranties	8	
Veterans' Administration	15, 986	
Defense Production Act of 1950, as amended	309	
Total loans guaranteed or insured by Government agencies	40, 069	462
Insurance in force:		
Agriculture Department:		
Federal Crop Insurance Corporation	[7] 307	
Civil Service Commission:		
Employees' life insurance	10, 084	3
Export-Import Bank of Washington	10	
Federal Deposit Insurance Corporation	120, 996	1, 830
Held by insured commercial and mutual savings banks		63, 465
Federal Home Loan Bank Board:		
Federal Savings and Loan Insurance Corporation	34, 000	258
Held by insured institutions		2, 559
Veterans' Administration:		
National service life insurance	41, 974	5, 472
United States Government life insurance	1, 632	1, 191
Total insurance in force	209, 003	74, 778
Obligations issued on credit of the United States:		
Postal savings certificates:		
United States Postal Savings System	[8] 1, 621	1, 616
Canal Zone Postal Savings System	[8] 6	7
Total postal savings certificates	1, 627	1, 623
Other obligations:		
Federal Reserve notes (face amount)	27, 476	[9] 24, 915
Undisbursed commitments, etc.:		
To make future loans:		
Agriculture Department:		
Commodity Credit Corporation	1	
Disaster loans, etc., revolving fund	2	
Farmers' Home Administration:		
Loan program	11	
Rural Electrification Administration	668	
Defense Department:		
Loan to Peru [5]	9	
Export-Import Bank of Washington:		
Regular lending activities	1, 553	
Defense Production Act of 1950, as amended	1	
Housing and Home Finance Agency:		
Office of the Administrator:		
College housing loans	138	
Liquidating programs	(3)	
Public facility loans	2	
Urban renewal fund	104	
Public Housing Administration	241	

See footnotes at end of table.

Long-range commitments and contingencies of the U. S. Government as of Dec. 31, 1956—Continued

[In millions of dollars]

Commitment or contingency and agency	Gross amount of commitment or contingency	Public debt securities held by Government and other agencies
Undisbursed commitments—Continued		
To make future loans:		
Interior Department:		
Defense Minerals Exploration Administration:		
Defense Production Act of 1950, as amended	6	
Virgin Islands Corporation	(3)	
International Cooperation Administration:		
Loans to foreign countries [5]	446	
Small Business Administration	37	
Treasury Department:		
Reconstruction Finance Corporation (in liquidation)	2	
Defense Production Act of 1950, as amended	7	
Federal Civil Defense Act of 1950, as amended	3	
Veterans' Administration (veterans' direct loan program)	21	
Total undisbursed commitments to make future loans	3,252	
Other undisbursed commitments:		
Agriculture Department:		
Commodity Credit Corporation	597	
Housing and Home Finance Agency:		
Federal National Mortgage Association:		
Management and liquidating functions	8	
Secondary market operations	2	
Special assistance functions	(3)	
Treasury Department:		
Federal Facilities Corporation	2	
All other	(3)	
Total other undisbursed commitments	609	
To purchase mortgages:		
Agriculture Department:		
Farmers' Home Administration:		
Farm tenant mortgage insurance fund	(3)	
Housing and Home Finance Agency:		
Federal National Mortgage Association:		
Management and liquidating functions	8	
Secondary market operations	283	
Special assistance functions	69	
Total commitments to purchase mortgages	360	
To guarantee and insure loans:		
Agriculture Department:		
Farmers' Home Administration:		
Farm tenant mortgage insurance fund	8	
Commerce Department:		
Federal Maritime Board and Maritime Administration	18	
Housing and Home Finance Agency:		
Federal Housing Administration	3,672	
Small Business Administration	7	
Defense Production Act of 1950, as amended	102	
Total commitments to guarantee and insure loans	3,807	
Unpaid subscriptions:		
International Bank for Reconstruction and Development	2,540	

[1] The Corporation finances part of its activities by issuing certificates of interest to private lending agencies. The outstanding amount of $208 million as of Dec. 31, 1956, is included in this figure.
[2] Includes accrued interest of $1 million.
[3] Less than $500,000.
[4] Represents the Administration's portion of insurance liability. The estimated amount of insurance in force and loan reports in process as of Dec. 31, 1956, is $1,081 million. Insurance on loans shall not exceed 10 percent of the total amount of such loans.
[5] The Export-Import Bank of Washington acts as agent in carrying out this program.
[6] Includes loans sold subject to repurchase agreements and deferred participation agreements.
[7] Represents estimated insurance coverage for the 1956 crop year.
[8] Excludes accrued interest.
[9] Includes public debt securities amounting to $17,605 million that have been deposited with the Federal Reserve agents as specific collateral.

NOTE.—The above figures are subject to the limitations and precautionary remarks as explained in the note attached to this statement.

Exhibit C

Debt of Federal Government agencies not guaranteed as to principal and interest by the United States Dec. 31, 1956

[In millions of dollars]

Federal home loan banks	963
Federal intermediate credit banks	705
Banks for cooperatives	143
Federal National Mortgage Association:	
Management and liquidation	570
Secondary market operation	200
Total, nonguaranteed agency debt	[1] 2,581

[1] Excludes $1,437 million debt of the land banks, which are not classified as a Federal Government agency, since the Government no longer has any capital investment in them and their market borrowing terms do not have to be approved by the Secretary of the Treasury.

Exhibit D

LEGISLATIVE AUTHORITY RELATING TO THE PUBLIC DEBT

The earliest of all public debt statutes (act of August 4, 1790, 1 Stat. 138), which provided for the payment of the foreign debt and the funding of the domestic debt existing at the inception of the new Government as well as the assumption of the debts of the several States, authorized the President to borrow money on the credit of the United States for those purposes. The authority of the President was delegated by him to his Secretary of the Treasury, Alexander Hamilton. This pattern of responsibility continued in general until the Civil War period when the acts of July 17 and August 5, 1861 (12 Stat. 259, 313), without references to the President, authorized the Secretary of the Treasury to borrow money for financing the Civil War through the issuance of bonds, 1-year notes, and demand notes.

From the close of the Civil War period until our entrance into World War I, there were enacted numerous laws authorizing the Secretary of the Treasury to borrow upon the credit of the United States. Beginning with the First Liberty Bond Act (40 Stat. 35) and continuing until the present time, the borrowing authority vested in the Secretary has been subject to approval by the President in respect to the issuance of bonds and notes. Existing law (31 U. S. C. 754b) provides that the decision of the Secretary of the Treasury in respect to the terms and conditions of any bonds, notes, bills, or certificates of indebtedness which he may issue shall be final.

It may be stated that prior to World War I, the acts of Congress authorizing the issuance of public debt obligations usually specified the terms and conditions which were to attach to such obligations and vested but little discretion in the Secretary of the Treasury. As a typical example, there may be cited sections 32 and 33 of the act of June 13, 1898 (30 Stat. 466), which authorized the Secretary of the Treasury to issue certificates of indebtedness and bonds to finance the war with Spain.

In authorizing the borrowings incidental to the participation of the United States in World War I, the Congress departed from its previous policy of specifying the terms and conditions of the obligations to be issued. The First, Second, Third, and Fourth Liberty Bond Acts (40 Stat. 35, 288, 502, 844, 1917–19), and the Victory Liberty Loan Act (40 Stat. 1309, 1919), with the exception of certain maximum rates of interest which were prescribed by the Congress, gave the Secretary of the Treasury broad authority to determine the terms and conditions of issue, conversion, redemption, maturities, payment, and the rate and time of payment of interest in respect to the several classes of obligations authorized to be issued.

The basic authority for the issuance of securities of the United States is now contained in the Second Liberty Bond Act, as amended. Section 1 of that act (31 U. S. C. 752) authorizes the Secretary of the Treasury, with the approval of the President to issue bonds "in such forms and denomination or denominations and subject to such terms and conditions of issue, conversion, redemption, maturities, payment, and rate or rates of interest, not exceeding 4¼ percent per annum, and time or times of payment of interest, as the Secretary of the Treasury from time to time at or before the issue thereof may prescribe." Other provisions of the amended act vest comparable authority in the Secretary of the Treasury in respect to theissuance of bills, notes, certificates of indebtedness, and savings bonds, except that the issuance of bills and certificates of indebtedness does not require Presidential approval.

From time to time, the Congress has broadened the powers of the Secretary of the Treasury in respect to the conduct of public debt operations by authorizing him to issue new types of public debt obligations. By an amendment to the Second Liberty Bond Act, approved June 17, 1929 (31 U. S. C. 754), the Secretary of the Treasury was authorized to issue Treasury bills on a discount basis with maturities not in excess of 1 year.

A further amendment to that act, approved February 4, 1935, and broadened by the Public Debt Act of 1941, and the act approved April 20, 1957, Public Law 85–17[1] (31, U. S. C. 757c), authorized the Secretary of the Treasury to issue United States savings bonds on an interest-bearing basis, on a discount basis, or a combination interest-bearing and discount basis. These securities may be issued with a maturity of not more than 20 years and an investment yield of not more than 3.26 percent per annum compounded semiannually. They are now issued continuously in 2 series, both of which are nontransferable and subject to a limitation on holdings: Series E, an 8-year 11-month discount bond with an investment yield of 3.25 percent per annum compounded semiannually if held to maturity, and series H, a 10-year current income bond with an investment yield of 3.25 percent per annum compounded semiannually, if held to maturity.

The Congress, by an act approved March 26, 1951, Public Law 12, 82d Congress, granted additional authority to the Secretary of the Treasury in the conduct of public debt operations by amending section 22 of the Second Liberty Bond Act (31 U. S. C. 757c (b)) to authorize the Secretary of the Treasury, with the approval of the President, to provide by regulation that owners of series E savings bonds thereafter maturing may, at their option, retain the matured bonds and earn interest upon the maturity values thereof for not more than 10 years. This authority was broadened by the act approved April 20, 1957, Public Law 85–17.[2]

Under the general authority granted by the Second Liberty Bond Act, as amended, the Secretary of the Treasury has from time to time issued a number of other classes of obligations. The Secretary has offered two series of nonmarketable Treasury bonds during the last decade: Investment series A, issued in 1947, which have an 18-year maturity and are restricted in ownership to specified classes of institutional investors; and investment series B, offered in 1951 only in exchange for 2½ percent Treasury bonds of June and December 1967–72, and not redeemable prior to call or maturity but exchangeable at any time for marketable 1½ percent, 5-year Treasury notes. In 1952 the Secretary of the Treasury offered an additional amount of bonds of this series in exchange for the 2½ percent Treasury bonds of 1967–72 and 2½ percent Treasury bonds of 1965–70 and 1966–71. Special issues to Government agencies and trust funds are also issued under this same general authority.

There were also issued under this authority a class of Treasury obligations designed primarily for use in direct payment of taxes known as Treasury savings notes, typically a 3-year nontransferable note issued continuously, bearing interest payable on redemption and redeemable prior to maturity; issuance of these securities ceased on October 23, 1953, and the last issue has now matured.

Prior to the act approved July 20, 1939 (53 Stat. 1071), there was a specific limit for the total amount of bonds and various specific limits for the amounts of Treasury notes, certificates of indebtedness, and Treasury bills which could be outstanding under the Second Liberty Bond Act, as amended. The act of July 20, 1939, removed these specific limitations and subjected the aggregate amount of all obligations which might be outstanding under the Second Liberty Bond Act, as amended, to a general limitation, then placed at $45 billion. Four

[1] This law authorized the Secretary of the Treasury to issue savings bonds bearing issue dates of February 1, 1957, or thereafter, with an investment yield not to exceed 3.26 percent per annum compounded semiannually. Prior to the enactment of this law the yield was limited to 3 percent per annum compounded semiannually. See footnote 2 for authority granted by this law with respect to the yield after maturity on bonds of series E.

[2] This law authorized an increase in the yield on savings bonds of series E maturing on or after February 1, 1957, up to 3.26 percent per annum compounded semiannually, but only with respect to the investment yield after maturity.

billion dollars of national defense series obligations redeemable from a special fund were authorized to be outstanding under an amendment to the Second Liberty Bond Act added by the First Revenue Act of 1940 but repealed on February 19, 1941, when the general limitation was raised to $65 billion.

The public debt limitation was raised under subsequent acts; a high of $300 billion was reached in the act of April 3, 1945, but the limit was lowered to $275 billion on June 26, 1946, is presently $278 billion and will revert to $275 billion beginning July 1, 1957.

The public debt limitation at the present time applies to the current redemption value of savings bonds and the face amount of other outstanding obligations issued under the authority of the Second Liberty Bond Act and to the face amount of all fully guaranteed obligations, except those held by the Secretary of the Treasury. (The amount of guaranteed obligations includible in the debt limitation is $102,728,375 as of April 30, 1957.)

As of April 30, 1957, there were oustanding $273,662,166,815.32 in obligations subject to the limitation. It is obvious, of course, that the size of the public debt is not determined by the public debt limitation but rather by the relationship of the expenditures authorized by the Congress to the receipts derived from internal revenue and other sources.

Prior to the enactment of the First Liberty Bond Act, approved April 24, 1917, acts authorizing the issuance of United States securities provided in substance that the securities issued should be exempt, both as to principal and interest, from any taxation by the United States or any of its possessions, or by any State, municipal, or local taxing authority. When the First Liberty Bond Act was enacted followed shortly by the Second Liberty Bond Act of September 24, 1917; some changes were made in the language governing tax exemptions; and estate and inheritance taxes, whether Federal or State; were expressly made an exception. The Second Liberty Bond Act exemption language was somewhat broadened to include in the exception from exemption not only estate and inheritance taxes, but also graduated additional income taxes commonly known as surtaxes, and excess-profits and war-profits taxes imposed by the United States. This applied to bonds, certificates of indebtedness, and bills. Treasury notes, however, could be issued with any one of four exemptions, none of which was broader than the exemptions found in the Second Liberty Bond Act regarding bonds and certificates.

These tax exemption provisions continued until the Public Debt Act of 1941 which made all obligations of the United States issued on or after March 1, 1941 (with very minor exceptions)[3] subject to all taxation under the Federal tax acts then or thereafter in force. This is the present law.

No discussion of legislative authority relating to the public debt would be complete without reference to the sinking fund. Congress has provided a number of different sinking fund arrangements to assist in the process of debt retirement since the first such statutes were passed in 1790 (I Stat. 138; I Stat. 186). The present sinking fund provisions (31 U. S. C. 767, 767a, and 767b) grow out of the Victory Loan Act approved March 3, 1919, and provide for an annual appropriation to the cumulative sinking fund. The sinking fund is essentially a mechanical device to provide a basic framework for orderly debt retirement. Its effectiveness, of course—like the effectiveness of the statutory debt limitation—depends, in the last analysis, on whether the Federal Government is operating at a surplus of budget revenues over expenditures. This is the only way debt reduction—either with or without a sinking fund—can take place.

The Secretary of the Treasury, in addition to any authorization contained in sinking fund legislation, is also authorized at his discretion to use surplus moneys for the purchase or redemption of the public debt: Such authority is contained in the act of March 3, 1881 (31 U. S. C. 741), which authorizes the Secretary of the Treasury to apply any surplus money in the Treasury to the purchase or redemption of United States bonds subject to the proviso that any bonds so purchased shall not constitute a part of the sinking fund but shall be canceled. In addition, broad authority is granted to the Secretary of the Treasury by section 19 of the Second Liberty Bond Act, as amended (31 U. S. C. 754a), to issue obligations thereunder for the purchase, redemption, or refunding of any outstanding obligations of the United States, and to use any money received from the sale of such obligations, or any other money in the general fund of the Treasury for such purposes.

[3] Obligations which the U. S. Maritime Commission or the Federal Housing Administration had contracted prior to March 1, 1941, to issue at a future date.

Public Debt, Guaranteed Obligations, Etc.—I. Outstanding

Table 16.—*Principal of the public debt, 1790–1956*

[On basis of public debt accounts from 1790 through 1919, and on basis of daily Treasury statements from 1920 to date, see "Bases of tables" and note]

Date	Total gross debt	Date	Total gross debt	Date	Total gross debt
December 31—		December 31—		December 31—	
1790	$75,463,477	1812	$55,962,828	1833	$4,760,082
1791	77,227,925	1813	81,487,846	1834	37,733
1792	80.358,634	1814	99,833,660	1835	37,513
1793	78,427,405	1815	127,334,934	1836	336,958
1794	80.747,587	1816	123,491,965	1837	3,308,124
1795	83,762,172	1817	103,466,634	1838	10,434,221
1796	82,064,479	1818	95,529,648	1839	3,573,344
1797	79,228,529	1819	91,015,566	1840	5,250,876
1798	78,408,670	1820	89,987,428	1841	13,594,481
1799	82,976,294	1821	93,546,677	1842	20,201,226
1800	83,038,051	1822	90,875,877	June 30—	
1801	80,712,632	1823	90,269,778	1843	32,742,922
1802	77,054,686	1824	83,788,433	1844	23,461,653
1803	86,427,121	1925	81,054,060	1845	15,925,303
1804	82,312,151	1826	73,987,357	1846	15,550,203
1805	75,723,271	1827	67.475,044	1847	38,826,535
1806	69,218,399	1828	58.421,414	1848	47,044,862
1807	65,196,318	1829	48,565,407	1849	63,061,859
1808	57,023,192	1830	39,123,192	1850	63,452,774
1809	53,173,218	1831	24,322,235	1851	68,304,796
1810	48,005,588	1832	7,011,699	1852	66,199,342
1811	45,209,738				

June 30	Interest-bearing [1]	Matured debt on which interest has ceased	Debt bearing no interest	Total gross debt	Gross debt per capita [2]
1853	$59,642,412	$162,249		$59,804,661	$2.32
1854	42,044,517	199,248		42,243,765	1.59
1855	35,418,001	170,498		35,588,499	1.30
1856	31,805,180	168,901		31,974,081	1.13
1857	28,503,377	197,998		28,701,375	.99
1858	44,743,256	170,168		44,913,424	1.50
1859	58,333,156	165,225		58,498,381	1.91
1860	64,683,256	160,575		64,843,831	2.06
1861	90,423,292	159,125		90,582,417	2.80
1862	365,356,045	230,520	$158,591,390	524,177,955	15.79
1863	707,834,255	171,970	411,767,456	1,119,773,681	32.91
1864	1,360,026,914	366,629	455,437,271	1,815,830,814	52.08
1865	2,217,709,407	2,129,425	458,090,180	2,677,929,012	75.01
1866	2,322,116,330	4,435,865	429,211,734	2,755,763,929	75.42
1867	2,238,954,794	1,739,108	409,474,321	2,650,168,223	70.91
1868	2,191,326,130	1,246,334	390,873,992	2,583,446,456	67.61
1869	2,151,494,065	5,112,034	388,503,491	2,545,110,590	65.17
1870	2,035,881,095	3,569,664	397,002,510	2,436,453,269	61.06
1871	1,920,696,750	1,948,902	399,406,489	2,322,052,141	56.72
1872	1,800,794,100	7,926,547	401,270,191	2,209,990,838	52.65
1873	1,696,483,950	51,929,460	402,796,935	2,151,210,345	50.02
1874	1,724,930,750	3,216,340	431,785,640	2,159,932,730	49.05
1875	1,708,676,300	11,425,570	436,174,779	2,156,276,649	47.84
1876	1,696,685,450	3,902,170	430,258,158	2,130,845,778	46.22
1877	1,697,888,500	16,648,610	393,222,793	2,107,759,903	44.71
1878	1,780,735,650	5,594,070	373,088,595	2,159,418,315	44.82
1879	1,887,716,110	37,015,380	374,181,153	2,298,912,643	46.72
1880	1,709,993,100	7,621,205	373,294,567	2,090,908,872	41.60
1881	1,625,567,750	6,723,615	386,994,363	2,019,285,728	39.18
1882	1,449,810,400	16,260,555	390,844,689	1,856,915,644	35.16
1883	1,324,229,150	7,831,165	389,898,603	1,721,958,918	31.83
1884	1,212,653,850	19,655,955	393,087,639	1,625,307,444	29.35
1885	1,182,150,950	4,100,745	392,299,474	1,578,551,169	27.86
1886	1,132,014,100	9,704,195	413,941,255	1,555,659,550	26.85
1887	1,007,692,350	6,114,915	451,678,029	1,465,485,294	24.75
1888	936,522,500	2,495,845	445,613,311	1,384,631,656	22.89
1889	815,853,990	1,911,235	431,705,286	1,249,470,511	20.23
1890	711,313,110	1,815,555	409,267,919	1,122,396,584	17.80
1891	610,529,120	1,614,705	393,662,736	1,005,806,561	15.63
1892	585,029,330	2,785,875	380,403,636	968,218,841	14.74
1893	585,037,100	2,094,060	374,300,606	961,431,766	14.36
1894	635,041,890	1,851,240	380,004,687	1,016,897,817	14.89
1895	716,202,060	1,721,590	378,989,470	1,096,913,120	15.76

Footnotes at end of table.

TABLE 16.—*Principal of the public debt, 1790–1956*—Continued

June 30	Interest-bearing [1]	Matured debt on which interest has ceased	Debt bearing no interest	Total gross debt	Gross debt per capita [2]
1896	$847, 363, 890	$1, 636, 890	$373, 728, 570	$1, 222, 729, 350	$17. 25
1897	847, 365, 130	1, 346, 880	378, 081, 703	1, 226, 793, 713	16. 90
1898	847, 367, 470	1, 262, 680	384, 112, 913	1, 232, 743, 063	16. 77
1899	1, 046, 048, 750	1, 218, 300	389, 433, 654	1, 436, 700, 704	19. 21
1900	1, 023, 478, 860	1, 176, 320	238, 761, 733	1, 263, 416, 913	16. 60
1901	987, 141, 040	1, 415, 620	233, 015, 585	1, 221, 572, 245	15. 74
1902	931, 070, 340	1, 280, 860	245, 680, 157	1, 178, 031, 357	14. 88
1903	914, 541, 410	1, 205, 009	243, 659, 413	1, 159, 405, 913	14. 38
1904	895, 157, 440	1, 970, 920	239, 130, 656	1, 136, 259, 016	13. 83
1905	895, 158, 340	1, 370, 245	235, 828, 510	1, 132, 357, 095	13. 51
1906	895, 159, 140	1, 128, 135	246, 235, 695	1, 142, 522, 970	13. 37
1907	894, 834, 280	1, 086, 815	251, 257, 098	1, 147, 178, 193	13. 19
1908	897, 503, 990	4, 130, 015	276, 056, 398	1, 177, 690, 403	13. 28
1909	913, 317, 490	2, 883, 855	232, 114, 027	1, 148, 315, 372	12. 69
1910	913, 317, 490	2, 124, 895	231, 497, 584	1, 146, 939, 969	12. 41
1911	915, 353, 190	1, 879, 830	236, 751, 917	1, 153, 984, 937	12. 29
1912	963, 776, 770	1, 760, 450	228, 301, 285	1, 193, 838, 505	12. 52
1913	965, 706, 610	1, 659, 550	225, 681, 585	1, 193, 047, 745	12. 27
1914	967, 953, 310	1, 552, 560	218, 729, 530	1, 188, 235, 400	11. 99
1915	969, 759, 090	1, 507, 260	219, 997, 718	1, 191, 264, 068	11. 85
1916	971, 562, 590	1, 473, 100	252, 109, 878	1, 225, 145, 568	12. 02
1917	2, 712, 549, 477	14, 232, 230	248, 836, 878	2, 975, 618, 585	28. 77
1918	11, 985, 882, 436	20, 242, 550	237, 503, 733	12, 243, 628, 719	117. 11
1919	25, 234, 496, 274	11, 109, 370	236, 428, 775	25, 482, 034, 419	242. 54
1920	24, 062, 500, 285	6, 745, 237	230, 075, 945	24, 299, 321, 467	228. 23
1921	23, 738, 900, 085	10, 688, 160	227, 862, 308	23, 977, 450, 553	220. 91
1922	22, 710, 338, 105	25, 250, 880	227, 792, 723	22, 963, 381, 708	208. 65
1923	22, 007, 043, 612	98, 738, 910	243, 924, 844	22, 349, 707, 365	199. 64
1924	20, 981, 242, 042	30, 278, 200	239, 292, 747	21, 250, 812, 989	186. 23
1925	20, 210, 906, 915	30, 258, 980	275, 027, 993	20, 516, 193, 888	177. 12
1926	19, 383, 770, 860	13, 359, 900	246, 085, 555	19, 643, 216, 315	167. 32
1927	18, 252, 664, 666	14, 718, 585	244, 523, 681	18, 511, 906, 932	155. 51
1928	17, 317, 694, 182	45, 335, 060	241, 263, 959	17, 604, 293, 201	146. 09
1929	16, 638, 941, 379	50, 749, 199	241, 397, 905	16, 931, 088, 484	139. 04
1930	15, 921, 892, 350	31, 716, 870	231, 700, 611	16, 185, 309, 831	131. 51
1931	16, 519, 588, 640	51, 819, 095	229, 873, 756	16, 801, 281, 492	135. 45
1932	19, 161, 273, 540	60, 079, 385	265, 649, 519	19, 487, 002, 444	156. 10
1933	22, 157, 643, 120	65, 911, 170	315, 118, 270	22, 538, 672, 560	179. 48
1934	26, 480, 487, 870	54, 266, 830	518, 386, 714	27, 053, 141, 414	214. 07
1935	27, 645, 241, 089	230, 662, 155	824, 989, 381	28, 700, 892, 625	225. 55
1936	32, 988, 790, 135	169, 363, 395	620, 389, 964	33, 778, 543, 494	263. 79
1937	35, 800, 109, 418	118, 529, 815	505, 974, 499	36, 424, 613, 732	282. 75
1938	36, 575, 925, 880	141, 362, 460	447, 451, 975	37, 164, 740, 315	286. 27
1939	39, 885, 969, 732	142, 283, 140	411, 279, 539	40, 439, 532, 411	308. 98
1940	42, 376, 495, 928	204, 591, 190	386, 443, 919	42, 967, 531, 038	325. 23
1941	48, 387, 399, 539	204, 999, 860	369, 044, 137	48, 961, 443, 536	367. 09
1942	71, 968, 418, 098	98, 299, 730	355, 727, 288	72, 422, 445, 116	537. 13
1943	135, 380, 305, 795	140, 500, 090	1, 175, 284, 445	136, 696, 090, 330	999. 83
1944	199, 543, 355, 301	200, 851, 160	1, 259, 180, 760	201, 003, 387, 221	1, 452. 44
1945	256, 356, 615, 818	268, 667, 135	2, 056, 904, 457	258, 682, 187, 410	1, 848. 60
1946	268, 110, 872, 218	376, 406, 860	934, 820, 095	269, 422, 099, 173	1, 905. 42
1947	255, 113, 412, 039	230, 913, 536	2, 942, 057, 534	258, 286, 383, 109	1, 792. 05
1948	250, 063, 348, 379	279, 751, 730	1, 949, 146, 403	252, 292, 246, 513	1, 720. 71
1949	250, 761, 636, 723	244, 757, 458	1, 763, 965, 680	252, 770, 359, 860	1, 694. 75
1950	255, 209, 353, 372	264, 770, 705	1, 883, 228, 274	257, 357, 352, 351	1, 696. 68
1951	252, 851, 765, 497	512, 046, 600	1, 858, 164, 718	255, 221, 976, 815	1, 653. 42
1952	256, 862, 861, 128	418, 692, 165	1, 823, 625, 492	259, 105, 178, 785	[3] 1, 650. 06
1953	263, 946, 017, 740	298, 420, 570	1, 826, 623, 328	266, 071, 061, 639	[3] 1, 666. 74
1954	268, 909, 766, 654	437, 184, 655	1, 912, 647, 799	271, 259, 599, 108	[3] 1, 670. 14
1955	271, 741, 267, 507	588, 601, 480	2, 044, 353, 816	274, 374, 222, 803	[3] 1, 660. 15
1956	269, 883, 068, 041	666, 051, 697	2, 201, 693, 911	272, 750, 813, 649	1, 622. 64

[1] Exclusive of bonds issued to the Pacific railroads (acts of 1862, 1864, and 1878), since statutory provision was made to secure the Treasury against both principal and interest, and the Navy pension fund, which was not a debt as principal and interest were the property of the United States. The Statement of the Public Debt included the railroad bonds from issuance and the Navy fund from Sept. 1, 1866, until the Statement of June 30, 1890. (See table 75 for Pacific railroad bonds.)
[2] Based on the Bureau of the Census estimated population for continental United States.
[3] Revised.

NOTE.—From 1789 to 1842, the fiscal year ended Dec. 31; from 1843, on June 30. Detailed figures for 1790–1852 are not available on a basis comparable with those of later years. The amounts for 1790–1852, except for 1835, are from the 1900 annual report of the Secretary of the Treasury; for 1835, from the 1834–35 annual reports, pp. 504 and 629; for 1853–85, from the "Statement of Receipts and Expenditures of the Government from 1855 to 1885 and Principal of Public Debt from 1791 to 1885" compiled from the Register's official records; from 1886-1919, from the monthly debt statements and revised figures in the Secretary's annual reports; and for 1920 to date, from the "Statement of the Public Debt" in the daily Treasury statements.

TABLE 17.—*Public debt and guaranteed obligations outstanding, June 30, 1934–56*

[Gross public debt on basis of daily Treasury statements. Guaranteed obligations from 1934 through 1939 on basis of Public Debt accounts, and for 1940 and subsequent years on basis of daily Treasury statements]

June 30	Gross public debt [1]	Guaranteed obligations held outside the Treasury [2]			Total gross public debt and guaranteed obligations [1]	
		Interest-bearing	Matured	Total	Total	Per capita [3]
1934	$27,053,141,414	$680,767,817		$680,767,817	$27,733,909,231	$219.46
1935	28,700,892,625	4,122,684,692		4,122,684,692	32,823,577,316	257.95
1936	33,778,543,494	4,718,033,242		4,718,033,242	38,496,576,735	300.63
1937	36,424,613,732	4,664,594,533	$10,000	4,664,604,533	41,089,218,265	318.95
1938	37,164,740,315	4,852,559,151	232,500	4,852,791,651	42,017,531,967	323.65
1939	40,439,532,411	5,450,012,899	821,200	5,450,834,099	45,890,366,510	350.63
1940	42,967,531,038	5,497,556,555	31,514,100	5,529,070,655	48,496,601,693	367.08
1941	48,961,443,536	6,359,619,105	10,633,475	6,370,252,580	55,331,696,116	414.85
1942	72,422,445,116	4,548,529,255	19,730,375	4,568,259,630	76,990,704,746	571.02
1943	136,696,090,330	4,091,686,621	8,256,425	4,099,943,046	140,796,033,376	1,029.82
1944	201,003,387,221	1,515,638,626	107,430,675	1,623,069,301	202,626,456,522	1,464.17
1945	258,682,187,410	409,091,867	24,066,525	433,158,392	259,115,345,802	1,851.70
1946	269,422,099,173	466,671,984	9,712,875	476,384,859	269,898,484,033	1,908.79
1947	258,286,383,109	83,212,285	6,307,900	89,520,185	258,375,903,294	1,792.67
1948	252,292,246,513	68,768,043	4,692,775	73,460,818	252,365,707,331	1,721.21
1949	252,770,359,860	23,862,383	3,413,025	27,275,408	252,797,635,268	1,694.93
1950	257,357,352,351	17,077,809	2,425,225	19,503,034	257,376,855,385	1,696.81
1951	255,221,976,815	27,364,069	1,863,100	29,227,169	255,251,203,984	[4] 1,653.61
1952	259,105,178,785	44,092,646	1,472,700	45,565,346	259,150,744,131	[4] 1,650.35
1953	266,071,061,639	50,881,686	1,191,075	52,072,761	266,123,134,400	[4] 1,667.06
1954	271,259,599,108	80,415,386	1,026,000	81,441,386	271,341,040,495	[4] 1,670.64
1955	274,374,222,803	43,257,786	885,175	44,142,961	274,418,365,764	[4] 1,660.41
1956	272,750,813,649	73,100,900	787,575	73,888,475	272,824,702,124	1,623.08

[1] Includes certain obligations not subject to statutory limitation. For amounts subject to limitation, see table 1.
[2] Consists of obligations issued by certain Government corporations and credit agencies, obligations which are guaranteed by the United States as to both principal and interest. They were first authorized in 1932, but no such obligations were outstanding at the end of the fiscal years 1932 and 1933.
[3] Based on Bureau of the Census estimated population for continental United States.
[4] Revised.

TABLE 18.—*Public debt outstanding by security classes, June 30, 1946–56*

[In millions of dollars. On basis of daily Treasury statements, see "Bases of tables"]

Class	June 30, 1946	June 30, 1947	June 30, 1948	June 30, 1949	June 30, 1950	June 30, 1951	June 30, 1952	June 30, 1953	June 30, 1954	June 30, 1955	June 30, 1956
Interest-bearing:											
Public issues:											
Marketable issues:											
Treasury bills	17,039	15,775	13,757	11,536	13,533	13,614	17,219	19,707	19,515	19,514	20,808
Certificates of indebtedness	34,804	25,296	22,588	29,427	18,418	9,509	28,423	15,854	18,405	13,836	16,303
Treasury notes	18,261	8,142	11,375	3,596	20,404	35,806	18,963	30,425	31,960	40,729	35,952
Treasury bonds:											
Bank eligible	65,864	69,686	62,826	60,789	53,159	42,772	48,200	63,980	71,706	81,057	81,840
Bank restricted [1]	53,459	49,636	49,636	49,636	49,636	36,061	27,460	17,245	8,672		
Panama-Canal loan bonds	50	50	50	50	50	50	50	50	50	50	50
Conversion bonds of 1946–47	13										
Postal savings bonds	117	116	114	112	110	106	92	74	46	21	
Total marketable issues	189,606	168,702	160,346	155,147	155,310	137,917	140,407	147,335	150,354	155,206	154,953
Nonmarketable issues:											
Treasury notes, tax series and savings series	6,711	5,560	4,394	4,860	8,472	7,818	6,612	4,453	5,079	1,913	
United States savings bonds	49,035	51,367	53,274	56,260	57,536	57,572	57,685	57,886	58,061	58,365	57,497
Depositary bonds	427	325	316	369	285	319	373	447	411	417	310
Armed forces leave bonds		1,793	563	396	297	47					
Treasury bonds—investment series			959	954	954	14,526	14,046	13,288	12,775	12,589	12,009
Total nonmarketable issues	56,173	59,045	59,506	62,839	67,544	80,281	78,717	76,073	76,326	73,285	69,817
Total public issues	245,779	227,747	219,852	217,986	222,853	218,198	219,124	223,408	226,681	228,491	224,769
Special issues:											
Adjusted service certificate fund (certificates)	12	12	6	6	5	5	5	5	5	5	5
Alaska Railroad retirement fund (notes)	2	3	3	3	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Canal Zone Postal Savings System (notes)	4	4	3	3	2	1	1	1	1	1	1
Canal Zone retirement fund (notes)	11	12	13	14	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Civil-service retirement fund (certificates)								846	2,268	4,055	6,051
Civil-service retirement fund (notes) [3]	2,155	2,435	2,795	3,238	3,801	4,374	4,998	4,739	3,571	2,097	596
Farm tenant mortgage insurance fund (notes)			1	1	1	1	1	1	1	1	
Federal Deposit Insurance Corporation (notes)	120	408	549	666	808	868	888	846	892	835	673
Federal home loans banks (certificates)											2
Federal home loans banks (notes)			37	117	119	77	50	50	232	200	50
Federal Housing Administration:											
Armed services housing mortgage insurance fund (notes)											2
Housing insurance fund (notes)							(4)	2	(4)		1
Housing investment insurance fund (notes)								(4)			
Military housing insurance fund (notes)								2		2	
Mutual mortgage insurance fund (notes)		14	4					16	10	16	26

National defense housing insurance fund (notes)								2	5	2	2
Sec. 220 housing insurance fund (notes)										1	1
Sec. 221 housing insurance fund (notes)										1	1
Servicemen's mortgage insurance fund (notes)										1	1
Title I housing insurance fund (notes)										1	1
Title I insurance fund (notes)										38	43
War housing insurance fund (notes)		3				7	2	4		3	8
Federal old-age and survivors insurance trust fund (certificates)	3,401	5,995	7,709	9,003	10,418	12,096	14,047	15,532	17,054	18,239	19,467
Federal old-age and survivors insurance trust fund (notes)	2,509	1,109									
Federal Savings and Loan Insurance Corporation (notes)	49	62	74	95	79	86	79	61	84	94	103
Foreign Service retirement fund (certificates)								3	9	10	16
Foreign Service retirement fund notes)	9	10	12	14	17	17	17	13	6	6	4
Government life-insurance fund (certificates)	682	1,254	1,286	1,318	1,292	1,300	1,300	1,299	1,234	1,233	1,217
Government life-insurance fund (notes)	2										
National service life-insurance fund (notes)	5,240	6,474	6,935	7,288	5,342	5,436	5,191	5,249	5,272	5,346	5,481
Postal Savings System (notes)	779	1,624	1,909	1,949	1,799	706	551	451	212	90	5
Railroad-retirement account (notes)	657	806	1,374	1,720	2,058	2,414	2,863	3,128	3,345	3,486	3,600
Unemployment trust fund (certificates)	6,699	7,142	7,500	7,340	6,616	7,266	7,745	8,287	8,024	7,479	7,737
Veterans special term insurance fund (certificates)								(4)	3	10	20
Total special issues	22,332	27,366	30,211	32,776	32,356	34,653	37,739	40,538	42,229	43,250	45,114
Total interest-bearing debt	268,111	255,113	250,063	250,762	255,209	252,852	256,863	263,946	268,910	271,741	269,883
Matured debt on which interest has ceased	376	231	280	245	265	512	419	298	437	589	666
Debt bearing no interest:											
Special notes of the United States:											
International Bank for Reconstruction and Development series		416	66	41							
International Monetary Fund series		1,724	1,161	1,063	1,270	1,283	1,274	1,302	1,411	1,567	1,742
United States savings stamps [5]	96	70	58	52	49	48	50	50	50	48	49
Excess profits tax refund bonds	58	19	9	5	3	2	2	1	1	1	1
United States notes (less gold reserve)	191	191	191	191	191	191	191	191	191	191	191
Deposits for retirement of national bank and Federal Reserve bank notes	584	517	459	407	365	328	301	277	254	232	213
Other debt bearing no interest	6	6	6	6	6	6	6	6	6	6	6
Total debt bearing no interest	935	2,942	1,949	1,764	1,883	1,858	1,824	1,827	1,913	2,044	2,202
Total gross debt [6]	269,422	258,286	252,292	252,770	257,357	255,222	259,105	266,071	271,260	274,374	272,751

[1] For explanation, see 1946 annual report, pp. 42, 43, and 654, subsequent reports, and footnote 5, p. 515 of the 1955 annual report.

[2] See footnote 3.

[3] Includes special issues transferred from the Canal Zone retirement fund and the Alaska Railroad retirement fund pursuant to the act of July 21, 1949 (5 Stat. 740).

[4] Less than $500,000.

[5] Postal savings stamps, obligations of the Postal Savings System, were sold from May 1, 1941, to Oct. 1, 1942, when they were replaced by United States war savings stamps. All outstanding stamps then became public debt obligations.

[6] Includes certain obligations not subject to statutory limitation. For amounts subject to limitation, see table 1.

NOTE.—For information on the composition of the public debt beginning June 30 1916, see 1947 annual report, p. 361. For reconciliation with basis of public debt accounts for 1956, see table 21.

(Whereupon, at 2:50 p. m. the committee was recessed subject to call.)

×

98

Union Calendar No. 228

85th Congress, 1st Session - - - - - House Report No. 647

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

REPORT

OF THE

JOINT ECONOMIC COMMITTEE

TO THE

CONGRESS OF THE UNITED STATES

JUNE 26, 1957.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
86006 WASHINGTON : 1957

98

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

CONTENTS

Union Calendar No. 228

85TH CONGRESS 1st Session } HOUSE OF REPRESENTATIVES { REPORT No. 647

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

JUNE 26, 1957.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. PATMAN, from the Joint Economic Committee, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Economic Committee prepared by the Subcommittee on Fiscal Policy was approved for transmission to the Congress by the full committee. The subcommittee is composed of Representative Wilbur D. Mills, chairman, Senators Paul H. Douglas, Joseph C. O'Mahoney, and Barry Goldwater, and Representative Thomas B. Curtis. The report sets forth the subcommittee's findings with respect to the broad outlines of fiscal action during the fiscal year 1958, which on the basis of both economic and budget prospects would be consistent with the Employment Act objectives of economic growth and stability.

INTRODUCTION

The Subcommittee on Fiscal Policy of the Joint Economic Committee conducted hearings on June 3–7, 13–14, 1957, on the fiscal policy implications of the economic outlook and budget developments. The purpose of these hearings was to examine the facts concerning current and prospective economic and budget developments upon which sound, responsible fiscal policy, consistent with the economic growth objectives of the Employment Act, should be based.

Discussion with 33 non-Government experts and with the Director of the Bureau of the Budget, the Secretary of the Treasury, and the Chairman of the Board of Governors of the Federal Reserve System focused on: (1) the current economic situation and prospects for the remainder of 1957 and for 1958; (2) the effect of current congressional and administrative efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957–58; (3) types of fiscal action consistent with economic stability and growth if spending reductions are achieved; and (4) the timing of fiscal action in relation to budgetary and economic developments. These discussions were directed toward the broad outlines of fiscal action which would best contribute to the setting within which our enterprise economy can proceed on a steady and noninflationary course of economic growth. Responsible fiscal policy calls for revenues adequate to finance Government activities, including debt management, in a manner which will contribute to economic stability and growth.

FINDINGS OF THE SUBCOMMITTEE ON FISCAL POLICY

Inflation is a grave economic problem facing the American economy today. Failure to deal with it forthrightly will result in increasing hardships for millions of Americans. It will impose the costs of economic instability on future generations by making achievement of steady economic progress increasingly difficult.

The rapid expansion of Federal Government spending in recent years, coming on top of sharp increases in consumption and investment in the private sectors of the economy, has contributed significantly to current inflationary pressures. Present fiscal and monetary restraints, such as the extension of tax rates otherwise scheduled for reduction, the application of modest surpluses to debt retirement, and general controls for restricting increases in the supply of credit, have not been fully effective in curbing pressures for widespread price increases.

Public policies must face up squarely to the problem of inflation. Restraining inflation never has been and never will be an easy job. It requires making hard decisions in public policies to contend with problems which may become increasingly complex. The current difficulties in management of the Federal debt offer an impressive example. Demands for immediate and substantial tax reduction and for more freely available credit are others. Steady economic growth and stable prices, however, will not be achieved unless we are guided by appraisal of the findings of objective and dispassionate inquiries.

The subcommittee's findings are:

(1) The economic outlook for the remainder of 1957 and early 1958 suggests continued increases in output and income. Although somewhat less buoyant than in 1956, total demand shows sufficient strength in widespread sectors of economic activity to point to continuing upward pressures on prices. Modest, e. g., $1 billion to $2 billion, reductions in Federal spending, with corresponding increases in the budget surplus in fiscal 1958, would not significantly affect these prospects.

At the same time, a number of soft spots in the economy emphasize the need for continuing alertness to possible changes in overall levels of economic activity which may require revisions in current public policies.[1] A downturn in economic activity would call for easing restraints. If relaxation of present general credit controls should prove inadequate to prevent a continuing decline in employment and output, general tax reduction should be provided.

(2) Barring an economic downturn, which seems unlikely at this time, tax reductions or easing monetary restraints in fiscal year 1958 should be based on realization of substantial, e. g., $3 billion to $5 billion, reductions in Federal expenditures during the year, if renewed acceleration of widespread price increases is to be avoided. The achievement in fiscal 1958 of such reductions in actual Federal spending below the January 1957 estimates would call for tax reductions effective with respect to a part of fiscal 1958, certainly not later than the beginning of fiscal 1959. Present prospects indicate a somewhat smaller surplus in fiscal 1958 than the $1.8 billion estimated in the President's January 1957 budget message. Rising prices, particularly for defense goods and services, appear to be largely responsible for the downward adjustment in the estimated surplus.

Under present conditions of high levels of employment and output, any modest surplus in the Federal budget should be applied to debt reduction. In addition to facilitating public debt management, this use of a budget surplus will reduce the demands imposed on monetary policy as a means of restraining inflationary pressures.

(3) In order to justify tax reduction under conditions of steady economic growth, more remains to be done by the Congress and the administration with respect to actual Federal spending in fiscal 1958 than has been accomplished to date. Actions so far undertaken by the Congress and the administration with respect to the President's 1958 budget proposals hold little promise for reduction in actual Federal spending in fiscal 1958. In several cases, these actions represent revisions of the estimated costs of specific programs presented in the President's January 1957 budget message. In other cases, appropriations have been cut without changing existing program obligations of the Federal Government, so that supplemental or deficiency appropriations will subsequently be necessary. Moreover, reductions in appropriations for fiscal 1958 may, in a number of cases, have little effect on actual expenditures during the year because of the carryover from fiscal 1957 of existing but unused obligational authority. In their efforts to reduce Federal spending, the Congress and the administration should recognize that decreases in budget estimates do not necessarily result in decreases in actual Government outlays.

(4) Several Federal spending programs appear to contain built-in expansion features. Federal Government commitments for old-age assistance, social-security benefits, and highway expenditures are but a few examples of Federal programs which will increase under present law provisions. Refunding maturing issues of the public debt may be expected to result in increases in interest costs, so long as the present tight money conditions persist. In addition, cost and price increases tend to result in increasing levels of Federal spending, even when no change in real terms is made in existing programs. Merely continuing

[1] Senator O'Mahoney wishes to add:
"Notable soft spots are present in the areas of agriculture and small business. Huge Government appropriations to take agricultural surpluses out of the market. instead of a constructive legislative solution that would make agriculture a self-supporting segment of the economy, and the rising rate of bankruptcy in the field of small business, are warning signals that cannot safely be ignored. In these two areas taxpayers who ought to be contributing to the tax receipts of the Government are not earning incomes upon which taxes can be paid."

present programs, therefore, may well result in rising levels of Federal spending over the next several years.

(5) Substantial reductions in Federal spending in fiscal 1958 and subsequent years will require downward revision of existing programs as well as forgoing new expenditures. Rising prices and costs, particularly in defense spending, suggest that such revisions may well be necessary even to hold fiscal 1958 expenditures to the level estimated in the President's budget message of January 1957.

(6) Many important considerations, other than those of maintaining stability in the general price level and a high rate of economic growth, enter into decisions about the kind and magnitude of Federal spending programs. It should be recognized, however, that under present economic conditions, widespread demands for tax reductions cannot be met without inflationary consequences unless Government spending is prevented from rising as rapidly as revenues. The Congress and the administration, therefore, should increase their efforts to find means for reducing the scope of present Federal spending programs. These efforts will have to go beyond elimination of waste and inefficiency. Close review of the substance of present programs, prospects for their future expansion or contraction, and their contributions to the Nation's economic progress compared with private uses of the resources they demand will be necessary to effect major reductions in Federal expenditures.

More than 60 percent of estimated budget expenditures for fiscal 1958, as proposed in the President's January 1957 budget message, is for major national security programs, including expenditures abroad. The Joint Economic Committee repeatedly has pointed out that our economy can support such heavy defense programs while increasing productive capacity and living standards in the private sectors of the economy. Nevertheless, national security expenditures require the use of large amounts of resources which might add significantly to the rate of economic growth. A prime objective of the Congress and the administration, therefore, should be to achieve the highest possible level of military competence at the least possible cost in terms of resources used.

Reductions in Federal spending should be carefully determined to avoid weakening our national security preparations and those Federal Government activities which contribute most to developing the material and human resources essential for economic growth. On the other hand, there need be little concern about possible adverse effects on the level of total economic activity resulting from imposing effective restraints on expansion of Federal expenditures. Appropriate tax and credit policy changes can provide adequate increases in private demand to afford employment for additions to the labor force and to plant and equipment, and also for any resources released through decreased Federal spending. Indeed, since continuation of the postwar average rate of growth in gross national product may be expected to produce about $3 billion annually in additional revenue, preventing further growth in Federal spending will permit substantial tax reductions contributing to a growing level of private demand.

(7) Present inflationary pressures frequently are attributed to the so-called cost-price push, as distinct from the traditional inflation resulting from excessive demand. Whether or not this distinction is valid, it is evident that general price increases can occur without

increasing unemployment only if demand is adequate to support the higher price level. The basic problem is an inadequate level of savings out of current income. An ever-increasing volume of real savings is needed to meet the economy's requirements for replacement of plant and equipment under inflated prices and for growth based upon full exploitation of rapid technological advances. Fiscal and monetary policies should be directed toward encouraging a higher level of voluntary real savings under the present conditions of inflationary pressure.

Since these objectives have not been fully accomplished, public policies to cope with increases in the price level must take the form of general fiscal and monetary restraints on the expansion of total spending. It is recognized that the burden of such restraints may not be evenly distributed throughout the economy. The burden of inflation, however, is far more inequitably distributed. The alternative to general fiscal and credit controls is some form of direct Government control over wage and price determination. The use of this type of control would produce results as bad, if not worse, than the inflation against which it would be directed, and should be avoided.

(8) The long-run growth conditions of our dynamic economy call for constant attention to revision of the Federal revenue structure. Structural changes which broaden the tax base and improve the fairness of our tax laws would permit substantial reductions in tax rates while maintaining necessary revenues and would contribute to steady economic growth. Such revision is a continuing responsibility of the administration and of the tax committees of the Congress. The timing of such revisions must give due consideration to the Government's revenue requirements and to economic conditions. Ill-timed structural changes may defeat their long-run objectives by promoting economic instability.

O